



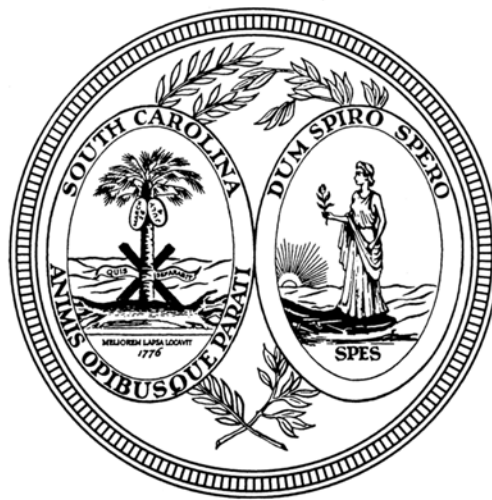
LAC

SOUTH CAROLINA GENERAL ASSEMBLY

# Legislative Audit Council

June 2019

## A REVIEW OF THE SOUTH CAROLINA EDUCATION LOTTERY AND ITS OVERSIGHT OF RETAILERS AND PLAYERS



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# Legislative Audit Council

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# Introduction

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## Audit Objectives

Sections 59-150-30(B) and 2-15-63(A) of the South Carolina Code of Laws require the Legislative Audit Council to conduct a management audit of the South Carolina Education Lottery (SCEL) every three years. Previous audits of SCEL were published in 2003, 2005, 2010, and 2014.

While conducting survey work on this audit, members of the General Assembly requested that we also review the appropriation and use of revenues received by SCEL. As a result, we conducted our review in two parts: (1) the appropriation and use of lottery funds, over which SCEL has no authority; and (2) the performance and management of SCEL. The first part of our review was published in June 2018.

In this report, we summarize the findings from the second part of our audit, which had the following objectives:

- Review the administrative costs and practices of SCEL.
- Review SCEL's internal controls related to the retail sale of tickets.
- Review SCEL's internal controls regarding frequent winners of lottery games.
- Determine whether SCEL "should be continued, revised, or eliminated," as required by S.C. Code §2-15-50(b)(2).

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## Scope and Methodology

This audit focused on the management and operations of SCEL. The period of our review was generally from FY 15-16 through FY 17-18 unless otherwise noted. To conduct this audit, we consulted:

- State laws and regulations.
- Agency financial statements.
- Agency contracts with retailers.
- Agency policies.
- Agency staff.
- Agency sales and ticket redemption data.
- Agency security records.
- University of California at Berkeley statistician.
- Lotteries and staff in other jurisdictions.

The criteria used to measure performance primarily include state law, agency policy, retailer contract, and practices in other jurisdictions. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## History

In 1974, the South Carolina Constitution was explicitly amended to prohibit lotteries in the state. In the 2000 general election, however, a ballot initiative was held on whether to amend the state constitution to allow the state government to operate a lottery. This amendment was approved with 54.3% of the vote, and it was ratified by the General Assembly on April 10, 2001. On June 13, 2001, the Governor signed the South Carolina Education Lottery Act, which formally established SCEL, making South Carolina the 38<sup>th</sup> state to establish a government-operated lottery. Sales of tickets began in January 2002. Since FY 02-03, the General Assembly has appropriated approximately \$5 billion in lottery funds for various programs.

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## Governance

SCEL is governed by a board of commissioners consisting of nine members who serve staggered three-year terms. Board members are appointed by the Governor, the President Pro Tempore of the Senate, and the Speaker of the House, who appoint three members each. As of May 2019, the board comprised only seven members, but it can still function normally as long as it maintains a quorum of at least five members.



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## **Process for Selling Lottery Tickets and Paying Out Prizes**

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SCEL is responsible for all duties related to operation, such as sales, advertising, licensing, and security.

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### **Sales of Lottery Tickets**

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SCEL employs marketing sales representatives (MSRs), who serve as liaisons between SCEL and lottery retailers, and perform tasks related to sales, retailer relations, and compliance with lottery rules and regulations. MSRs are supervised by sales managers in the Upstate, Midlands, and Coastal regions.

SCEL issues licenses to retailers around the state, allowing them to sell lottery products. The majority of the lottery retailers are convenience stores. In FY 16-17, convenience stores that also sold gasoline accounted for approximately 59% of lottery sales, and all convenience stores accounted for 82% of lottery sales.

SCEL sells two types of lottery games.

#### **SCRATCH-OFF GAMES**

These games involve scratching off a portion of a ticket to determine instantly whether the player is a winner. They are also known as instant games.

#### **DRAW GAMES**

To play these games, each player is required to select a series of numbers. Winning requires the selected numbers to match numbers randomly drawn by SCEL, Powerball, or Mega Millions. These games include:

- Pick 3
- Pick 4
- Palmetto Cash 5
- Lucky for Life
- Powerball
- Mega Millions

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## Paying Out Lottery Prizes

Winning tickets can be redeemed in several ways depending on the prize amount. Prizes of \$500 or less can be redeemed by any lottery retailer. Prizes up to \$100,000 can be redeemed via mail or in person by the state's only claims center, which is in Columbia. And prizes above \$100,000 must be redeemed in person at the claims center.

When redeeming tickets for prizes greater than \$500, claimants are required to provide personal information such as name, address, and social security number.

Our analysis in this report focused on tickets redeemed for prizes greater than \$500. As shown in Table 1.1, prizes for these tickets comprised only 0.03% of total prizes claimed during our review period — November 2008 through November 2017.

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**Table 1.1: Percentage of Claimed Lottery Prizes by Range, November 2008 – November 2017**

PRIZE RANGE	PRIZES CLAIMED*	PERCENTAGE OF PRIZES CLAIMED	PERCENTAGE OF PRIZES CLAIMED COMBINED
≤\$500	532,284,491	99.973433%	99.973433%
>\$500<\$5,000	124,346	0.023355%	0.026576%
≥\$5,000<\$10,000	11,065	0.002078%	
≥\$10,000<\$50,000	3,817	0.000717%	
≥\$50,000<\$100,000	533	0.000100%	
≥\$100,000<\$250,000	1,223	0.000230%	
≥\$250,000<\$500,000	330	0.000062%	
≥\$500,000<\$1,000,000	15	0.000003%	
≥\$1,000,000	123	0.000023%	
TOTAL	532,425,943	100.000000%	100.000000%

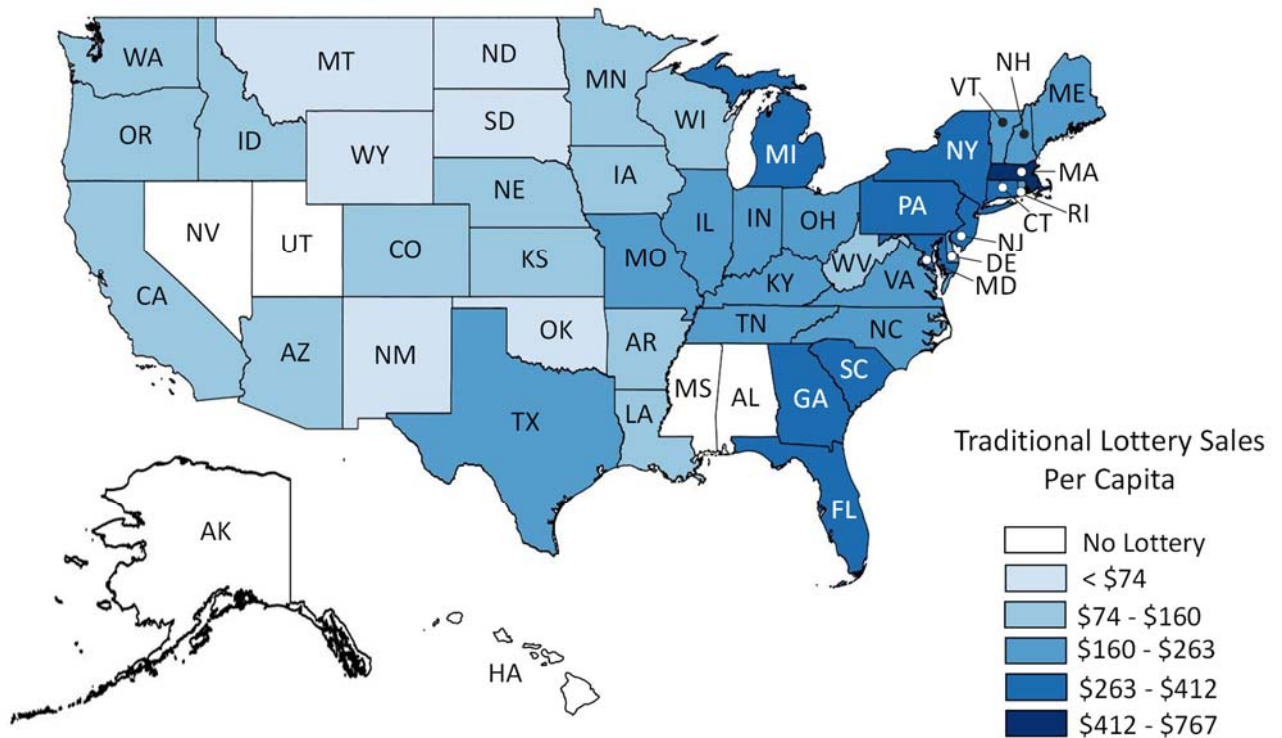
\*Prizes claimed means the number of tickets for which prizes were claimed.

Source: S.C. Education Lottery

## Revenues and Expenses

Out of the 44 states (and Washington, D.C.) that operate lotteries, South Carolina ranked 7<sup>th</sup> in per-capita traditional lottery game sales in FY 15-16, selling approximately \$327 in lottery products per person.

**Figure 1.2: FY 15-16 Traditional Lottery Sales Per Capita by State**

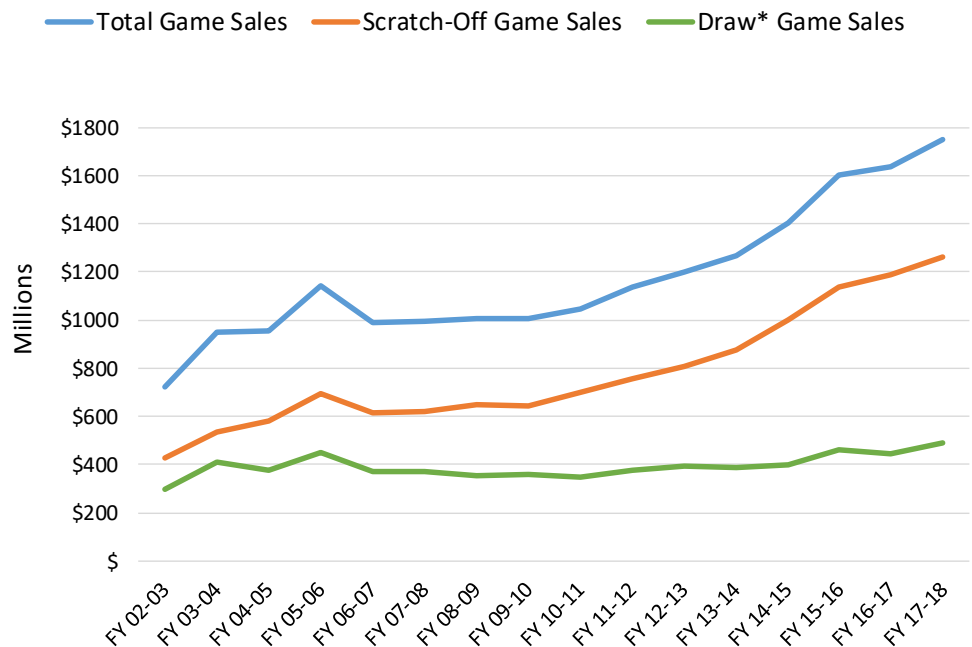


Note: "Traditional Lottery Sales" excludes revenues from video lottery draws, casinos, racinos, table games, charitable gaming, and games played solely on the Internet. Most, but not all, state fiscal years are from July 1 – June 30. State population statistics drawn from the 2015 American Community Survey 1-Year estimates.

Sources: State lottery FY 15-16 financial reports, U.S. Census

As shown in Graph 1.3, SCEL has seen steady growth in revenues, particularly from scratch-off games. Sales of draw games, however, have largely stayed constant since FY 03-04. Despite this, sales of draw games have remained an important source of revenue, accounting for over 40% of proceeds after prize payments in FY 16-17.

**Graph 1.3: SCEL Revenues,  
FY 02-03 – FY 16-17**



\* Draw games include the sale of Add-a-Play tickets.

Source: S.C. Education Lottery

As shown in Table 1.4, SCEL’s revenues in FY 17-18 were more than \$1.7 billion.

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**Table 1.4: FY 17-18 SCEL  
Revenues (in millions)**

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REVENUES	AMOUNT	PERCENT
Scratch-Off Games	\$1,260.6	71.9%
Draw Games	489.6	27.9%
Retailer Fees and Other	3.7	0.2%
<b>TOTAL</b>	<b>\$1,753.9</b>	<b>100.00%</b>

Source: S.C. Education Lottery

Table 1.5 shows SCEL expenses in FY 17-18, including funds transferred to the Education Lottery Account (ELA). Funds from the ELA are appropriated by the General Assembly every year for various programs and purposes (see our previous audit *South Carolina’s Use of Lottery Account Funds*).

S.C. Code §59-150-350(A) states that :

... [a]nnual administrative expenses must not exceed fifteen percent of gross lottery revenues for the year, including lottery retailer commissions and incentives...

S.C. Code §59-150-20(A)(1) excludes funds set aside for prizes from the definition of administrative expenses.

In Table 1.5, administrative expenses for FY 17-18 — which comprise the last three line items — equaled approximately 9.5% of total lottery revenues, which are shown in Table 1.4.

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**Table 1.5: FY 17-18 SCEL  
Expenses (in millions)**

EXPENSES	AMOUNT	PERCENT
Prize Payments	\$1,149.8	65.8%
Transfers to the Education Lottery Account	431.0	24.7%
Retailer Commissions and Incentives	123.5	7.1%
Operating Expenses	24.0	1.4%
Other Game-Related Costs	18.7	1.1%
<b>TOTAL</b>	<b>\$1,747.0</b>	<b>100.00%</b>

Note: Percentages have been rounded.

Source: S.C. Education Lottery

# Single Entity with Conflicting Incentives Established in State Law

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Under the authority of state law, the South Carolina Education Lottery (SCEL) maintains a statewide network of licensed retailers to sell tickets on behalf of the agency. Consistent with this role, SCEL is authorized to advertise and promote the lottery and its games. State law, however, also assigns SCEL the authority to oversee retailer and player behavior to detect and deter misconduct.

Because SCEL sells lottery tickets and is also responsible for overseeing the behavior of its retailers and customers, there may be reduced incentive to address misconduct that does not negatively affect sales. There also may be reduced incentive for SCEL to take actions that may reduce sales.

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## State Law

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SCEL's sales and oversight incentives can be seen in state law regarding the:

- Licensure of retailers to sell tickets.
- Marketing and advertising lottery games.
- Oversight of retailer and player behavior.

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## Licensure of Retailers

The licensure of retailers helps SCEL maintain a reliable network of sales outlets yet can provide leverage in ensuring the integrity of the retailer operations.

S.C. Code §59-150-150(A) states that SCEL:

... shall develop and maintain a statewide network of lottery retailers to serve the public convenience and promote the sale of tickets or shares and the playing of lottery games....

S.C. Code §59-150-165(A) states:

Any person required to undergo a background investigation pursuant to this chapter must undergo both a state and national criminal history background investigation as a part of the required investigation.

S.C. Regulation 44-20.40(A)(1) states:

The Executive Director shall license only those retail sales locations which will best serve the public interest and public trust in the lottery and promote the sale of lottery games. The Executive Director shall consider the following factors for licensure and renewal: (1) The moral character and reputation of the applicant....

S.C. Code §59-150-150(B)(4) states that, when SCEL finds misconduct, the retailer's license:

... may be suspended, revoked, or terminated for good cause by the executive director or his designee if the lottery retailer is found to have violated a provision of this chapter or the regulations....



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## Marketing and Advertising of Lottery Games

S.C. Code §59-150-60(A) authorizes SCEL to market, advertise, and promote the lottery and its games. SCEL marketing sales representatives (MSRs) visit retailers across the state on a regular basis to assist in maximizing sales. During those visits, the MSRs are also instructed to oversee retailer integrity by:

- Reviewing inventories of tickets to ensure that they are properly accounted for.
- Ensuring that tickets for specific games are sold before the games have ended.

MSRs may also observe the extent of compliance with state laws that require retailers to:

- Post information on the odds of winning and the risks of gambling.
- Accept only cash as payment for tickets.
- Sell tickets only to persons 18 or older.

When necessary, MSRs also assist SCEL in the physical removal of retailer licenses that have been revoked, including adversarial revocations initiated by SCEL.

### **Discontinued Sales Performance Incentives for MSRs**

Prior to August 2017, SCEL awarded its MSRs sales performance incentives of up to \$4,100 per year. When the practice was discontinued, SCEL awarded raises not tied to sales performance. By discontinuing these incentives, SCEL has reduced the potential for MSRs to be influenced by the goal of maximizing sales when carrying out their oversight responsibilities.

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## Oversight of Retailer and Player Behavior

SCEL is authorized to ensure compliance with state law and contract by retailers and players.

### **State Law**

S.C. Code §59-150-240(C)(3) authorizes SCEL to:

...[I]nspect, at times determined solely by the commission, the facilities or operations of a lottery vendor or lottery retailer to determine the integrity of the lottery vendor's product or compliance by the lottery retailer or lottery vendor with its contract...

S.C. Code §59-150-230(D) requires that SCEL deny payment of prizes for tickets purchased or sold in violation of the state's lottery statutes.

Contracts between SCEL and its retailers also give SCEL the authority to oversee the conduct of retailers.

### **Inadequate Incentive to Reduce Misconduct by Retailers and Players**

Some categories of misconduct by retailers and players, such as the following, do not decrease and may increase lottery ticket sales:

- Selling tickets to players under 18, which is prohibited by state law.
- Engaging in the resale of winning tickets, which we view as a potential violation of state law for retailers and for players, but which SCEL views only as contractual violations for retailers.

When retailer or player misconduct does not restrict SCEL in achieving its sales goals, or assists SCEL in achieving those goals, there may be inadequate incentive for SCEL to reduce the misconduct.

### **Inadequate Incentive to Implement Disciplinary Actions Against Retailers**

Suspending or revoking retailers' licenses for misconduct may decrease lottery ticket sales and restrict the ability of SCEL to achieve its goals, at least in the short run. As a result, there may be inadequate incentive for SCEL to impose such sanctions. In Chapters 3 and 4, we note that SCEL has:

- Not calculated the statistical probabilities of the patterns exhibited by retailers who have claimed large prizes frequently over time.
- Conducted only one statewide undercover review, in 2015, of a portion of its retailers for compliance with state laws and regulations. Lottery officials stated they intend to conduct this type of operation every few years and not on a continual basis.
- Not consistently established or enforced policies and regulations regarding retailer misconduct.

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## **Lotteries Outside South Carolina**

South Carolina's lottery is a member of the North American Association of State and Provincial Lotteries (NASPL). During our review, we identified a member of NASPL whose lottery retailers were regulated by a separate and independent entity. We also identified lotteries with structures similar to South Carolina's that conduct retailer oversight in a more aggressive manner.

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### **Retailer Oversight Conducted by an Independent Entity**

In March 2007, the Ombudsman of Ontario, Canada, stated that the Ontario Lottery and Gaming Corporation (OLG) was:

... hopelessly conflicted—it cannot be expected both to increase lottery profits by working with retailers, while at the same time acting as the sole body responsible for regulation and policy enforcement to keep retailers honest...

The OLG should be freed up to do what it does well – generating billions of dollars annually from the lottery business – and an independent regulator should be called upon to preserve “integrity, respect and accountability.”

In July 2007, Ontario assigned the role of overseeing OLG's lottery retailers to the Alcohol and Gaming Commission of Ontario, a separate and independent entity that does not sell lottery tickets. The AGCO is responsible for:

- Registering lottery retailers/sellers and employees who exercise significant decision-making authority or supervisory or training responsibility in relation to lottery games.
- Establishing standards and requirements for the conduct, management, and operation of the lottery.
- Testing and approving lottery equipment and procedures.
- Conducting inspections of retailers to ensure compliance with the [Gaming Control Act] and its regulation, the AGCO's standards and requirements as well as the OLG's Retailer Policy Manual.
- Investigating insider wins, suspicious wins, and complaints of criminal activity against retailers.

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### Lotteries with Structures Similar to South Carolina's but with More Aggressive Oversight of Retailers

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Although having a separate oversight entity can increase the independence of the oversight process, we identified lotteries with structures similar to South Carolina's that, nonetheless, have more aggressive oversight of their retailers.

#### NORTH CAROLINA

North Carolina subjects retailers filing claims for large prizes to extra scrutiny before paying the prizes to ensure that the retailers have purchased the tickets as players in a legal manner.

#### FLORIDA

Florida conducts ongoing law enforcement stings of retailers for misconduct and issues press releases when retailers are arrested and/or disciplined. Under this system, retailers are unlikely to know when a customer is an undercover agent.

#### MASSACHUSETTS

Massachusetts implemented a policy in 2018 of suspending the prize-claiming privileges of persons whose frequency of claiming prizes is highly improbable.

## Oversight of Alcohol, Tobacco, and Bingo Sales in South Carolina

**Table 2.1: Transfers of Revenue from Lottery Sales and from Taxes on Alcohol, Tobacco, and Bingo, FY 17-18 (in millions)**

Separate from SCEL, the South Carolina Department of Revenue (SCDOR) regulates and collects taxes from the private sale of alcohol, tobacco, and bingo. However, because SCDOR is not a seller, marketer, or advertiser of these products, it has greater regulatory independence than SCEL.

Table 2.1 shows \$431 million in lottery revenue transfers in FY 17-18 and \$355.9 million in transfers of tax revenues from alcohol, tobacco, and bingo.

STATE AGENCY COLLECTING REVENUE	CATEGORY OF REVENUE	AMOUNT TRANSFERRED
<b>SOUTH CAROLINA EDUCATION LOTTERY *</b>	Lottery Ticket Sales	\$431.0
<b>DEPARTMENT OF REVENUE **</b>	Beer and Wine Tax	\$107.7
	Liquor Tax	88.5
	Tobacco Tax	153.3
	Bingo Tax	6.4
<b>Total SCDOR</b>		\$355.9
<b>TOTAL Amount Transferred</b>		<b>\$786.9</b>

\* SCEL's transfer was made to the Education Lottery Account after deductions for administrative costs.

\*\* SCDOR's transfers were made primarily to the State General Fund and other state agencies without deductions for administrative costs.

Sources: S.C. Education Lottery and the S.C. Department of Revenue

## Recommendations

1. The General Assembly should consider amending state law to direct an entity independent of lottery sales — such as the S.C. Department of Revenue, another existing state agency, or a newly created state agency — to be responsible for issuing lottery licenses and overseeing compliance with state laws and regulations by retailers and players.
2. If the General Assembly does not implement recommendation 1, it should implement the recommendations in this report that suggest state law be amended to require the South Carolina Education Lottery to more aggressively oversee retailer and player integrity.



# Enforcement of Prohibitions Against the Resale of Winning Lottery Tickets

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We reviewed the issue of lottery players who frequently claim high-dollar prizes from winning tickets and found the following.

- It may violate State law to engage in the resale of winning lottery tickets, which is sometimes done by players with past due child support, taxes, and other debts to avoid the withholding or reporting of their winnings.
- SCEL has not regarded the resale of winning tickets as an illegal practice.
- Separate from state law, SCEL contractually prohibits its retailers from purchasing winning tickets from customers for less than the prize amounts.
- State law requires SCEL to deny claims for winning tickets that have been illegally purchased or sold.
- SCEL does not have an adequate process for determining whether winning tickets presented by retailers for redemption were obtained through the resale market prior to awarding prizes.
- Over a nine-year period, 18 individuals redeemed 50 or more winning tickets with prizes greater than \$500. We calculated that it was highly improbable that any player could have won as frequently through the routine purchase of tickets from SCEL. This high improbability raised questions regarding how the tickets were obtained.
- Although, prior to our review, SCEL identified all of the frequent prize claimants that we later identified, the agency had not conducted statistical analysis to quantify the improbability of the claiming patterns.
- Statistically improbable frequent prize claiming rates are not necessarily an indication of wrongdoing by retailers or players, but could be used as a basis for and a component of further and more effective investigation.

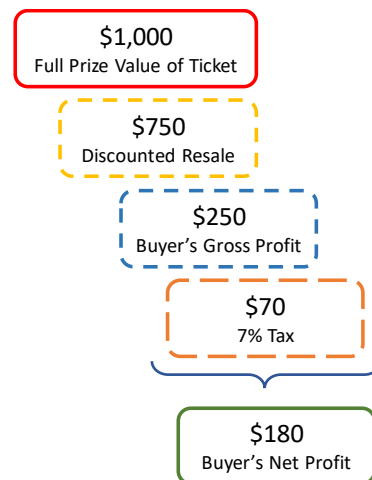
## Overview of the Resale of Winning Lottery Tickets

Individuals who frequently redeem winning lottery tickets for prizes greater than \$500 may not be buying their tickets from SCEL but in resale transactions from individuals seeking to avoid redeeming their winning tickets at the SCEL claims center in Columbia.

This practice has been analyzed and reported across the country. Buyers may pay discounted prices in relation to the prize amounts, resulting in net profits when they redeem the tickets. In some instances, buyers may be seeking to launder money earned from criminal activity.

Chart 3.1 contains an example of a resale transaction in which it is assumed that a player wins \$1,000 on a ticket and then resells the winning ticket for \$750 to a buyer. The buyer then redeems the \$1,000 winning ticket. After taxes (7%), the buyer's profit is \$180.

**Chart 3.1: Example of the Discounted Resale of Winning Tickets**



From the perspective of the seller, the incentive to engage in resale transactions with third parties may be to avoid having their prize winnings reported to the South Carolina and federal governments because of past due debts.

When lottery prizes are less than \$5,000, some players may sell their tickets to avoid having their winnings reported to state and federal tax agencies. The threshold for reporting to the South Carolina Department of Revenue is \$500, while the threshold for reporting to the federal Internal Revenue Service is \$600.



When prizes are \$5,000 and greater, some players may resell their winning tickets to avoid having their winnings *withheld* by SCEL to settle debts, such as past due taxes, student loans, child support, or other court-ordered payments. In certain instances, undocumented immigrants may sell their winning tickets to avoid interaction with government officials.

A SCEL official has stated that some resale transactions occur to accommodate individuals who are unable to travel to Columbia to collect their prize winnings. Columbia is the only location at which a ticket with a prize greater than \$500 may be redeemed. It is important to note, however, that tickets with prizes up to \$100,000 may be redeemed by mail without traveling to Columbia.

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## Resale of Winning Lottery Tickets May Violate State Law

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The resale of winning lottery tickets by retailers and regular lottery players may violate state law.

### **Tickets May Be Sold Only by Licensed Retailers at Licensed Retail Stores**

S.C. Code §§59-150-210(A) and (C) state, “[a] person, other than a duly certified lottery retailer, shall not sell lottery game tickets...” and “[a] lottery retailer shall not sell a lottery game ticket or share except from the locations listed in the lottery retailer’s contract...”

As defined in S.C. Code §59-150-20(8), a lottery retailer is “a person who sells lottery game tickets or shares on *behalf* of the South Carolina Lottery Commission pursuant to a contract.” [Emphasis added.]

Retailers who resell winning tickets are not acting as agents of SCEL and, therefore, are violating these provisions, regardless of where they sell these winning tickets. Regular lottery players who resell winning tickets are not certified retailers and, therefore, are in clear violation of these provisions.

### **Ticket Value Can Only Be Established by SCEL**

S.C. Code §59-150-210(A) also states, “A person shall not sell a lottery game ticket or share at a price other than that established by the [lottery] commission.” When reselling winning tickets, the resale price is lower than the prize amount but higher than the face value of the ticket.

### **Child Support and Tax Evasion**

S.C. Code §§63-5-20(A) and 12-54-44(B)(1) requires parents to pay child support and income earners to pay taxes, respectively. S.C. Code §59-150-330(D) requires SCEL to deduct debts in excess of \$100, such as past due child support or taxes, from prizes of \$5,000 or more. To avoid having outstanding debts deducted from a prize, an individual may sell a known winning ticket at a discount to a third party.

### **Other Contributing Factors**

Other states found that winning tickets were being purchased and then redeemed in money laundering schemes. Additionally, reselling winning tickets may allow individuals to profit from winning players without legal status or with mobility issues.

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## **SCEL's Interpretation that the Resale of Winning Tickets is Legal**

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Different from the LAC's interpretation of state law, SCEL states that it "has never interpreted" the law to prohibit the resale of winning tickets. During the course of our audit, SCEL provided several reasons for this interpretation.

### **Ticket or Prize or Bearer Instrument**

SCEL states that it does not consider the resale of a winning ticket to be "the sale of a ticket," but rather "the purchase of a prize" or "bearer instrument."

#### **LAC RESPONSE**

We reviewed the following definitions in state law and regulations.

#### **S.C. Code §59-150-20(18)**

Defines a lottery ticket as "tangible evidence issued by the South Carolina Lottery Commission to provide participation in a lottery game."

#### **S.C. Regulation 44.10(V)**

Defines a prize as "any award, financial or otherwise, awarded by the Commission."

#### **S.C. Regulation 44-80(C)**

Classifies a lottery ticket as a "bearer instrument" after a prize has been revealed but before it has been signed, meaning that the bearer is entitled to the prize.

Based on these definitions, a resale transaction is not the purchase of a prize but, rather, the purchase of a tangible object — a ticket — that has been issued by SCEL to provide participation in a lottery game. And, although we agree that an unsigned lottery ticket that has been revealed to contain a prize is a bearer instrument, it does not change the fact that it also fits the statutory definition of a “ticket.”

Furthermore, SCEL’s interpretation is inconsistent with the text of the Lottery Act and regulations, which make numerous references to “winning tickets,” “winning lottery game tickets,” and “nonwinning tickets,” implying that a lottery ticket remains a ticket after it has been revealed to be a winner or not.

SCEL’s retailer contract contains similar language, stating:

A [r]etailer, its employees, or agents may not  
*purchase a winning ticket* from a customer,  
regardless of the amount of the winnings, for less  
than the total prize amount won by the customer.  
[Emphasis added.]

In addition, the preface to SCEL’s retailer contract within its retailer applications states:

No matter the circumstances, “*buying*” a ticket from  
a customer and then attempting to claim a prize  
(either by you or a person acting on your behalf) will  
result in the revocation of your SCEL License(s) *and*  
*may result in criminal charges*. [Emphasis added.]

In these documents, SCEL appears to indicate that the item being purchased in a resale transaction is a ticket.

### **Game of Chance**

SCEL cites a 1939 S.C. Supreme Court case, *Darlington Theatres, Inc. v. Coker*, which describes the characteristics of a lottery, one of which is the element of chance. It is SCEL's view that, after a lottery ticket has been determined to be a winner or not, its winning status is no longer uncertain and from that point forward is no longer a game of chance and no longer a lottery ticket.

The agency stated:

Once the prize is revealed, the ticket is no longer a lottery ticket within the meaning of §59-150-210(A). It is now a bearer instrument. The chance of winning (or losing) is no longer present. Without the chance component, there is no lottery.

### **LAC RESPONSE**

It is our view that a lottery ticket fits the statutory definition of a "ticket" in S.C. Code §59-150-20(18) both before and after its prize winning status has been revealed. In either case, the ticket is a tangible object that has been issued by SCEL to provide participation in a lottery game.

It is also our view that participation in a lottery game for the bearer of a winning ticket continues until the bearer receives a prize payment from SCEL or an agent of SCEL in exchange for the ticket.

### **Authority of SCEL to Interpret State Law**

SCEL states that the LAC “cannot substitute its interpretation of the Lottery Act or regulations for that of SCEL.” The agency refers to:

... South Carolina’s deference doctrine,  
[under which] courts defer to an administrative  
agency’s interpretations with respect to the statutes  
entrusted to its administration or its own regulations  
‘unless there is a compelling reason to differ.’

SCEL cites the following passage from a 2014 S.C. Supreme Court case, *Kiawah Development Partners, II v. S.C. Department of Health and Environmental Control*:

...the deference doctrine properly stated provides  
that where an agency charged with administering a  
statute or regulation has interpreted the statute or  
regulation, courts, including the ALC, will defer to  
the agency’s interpretation absent compelling  
reasons. [The courts] defer to an agency’s  
interpretation unless it is “arbitrary, capricious, or  
manifestly contrary to statute.”

#### **LAC RESPONSE**

The same case, however, also states that:

Interpreting and applying statutes and regulations  
administered by an agency is a two-step process.  
*First, a court must determine whether the language  
of a statute or regulation directly speaks to the issue.  
If so, the court must utilize the clear meaning of the  
statute or regulation.* [Emphasis added.]

As shown above, state law does address the resale of lottery tickets. It is our interpretation that the clear meaning of the law is that this practice is illegal. Thus, SCEL’s interpretation to the contrary might not be owed deference by a court.

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## Statutory Prohibition Against Awarding Prizes for Tickets Purchased Illegally

S.C. Code §59-150-230(D) states, “[A] prize must not be paid upon a lottery game ticket or share purchased or sold in violation of this chapter and is an unclaimed prize for the purposes of this section.”

This statute does not provide the standard of proof required to deny such a claim. An amended state law explicitly prohibiting resale transactions might not need to require proof beyond a reasonable doubt that a ticket was purchased in violation of the lottery law but could, instead, require a lower standard of proof, such as clear and convincing evidence or preponderance of evidence.

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## Conclusion

Because of the differing interpretations of state law, we conclude that a formal opinion from the South Carolina Attorney General — who is authorized in S.C. Code §59-150-410 to enforce any provision of the Lottery Act — could clarify the legality of purchasing and selling winning lottery tickets in resale transactions.

If this practice were explicitly prohibited, it would increase the likelihood that enforcement action would be taken to detect and penalize offenders. This change could result in higher collections by SCEL for child support, taxes, and other debts.

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## Recommendations

3. The General Assembly should obtain a formal opinion from the Office of the Attorney General on the legality of purchasing and selling winning lottery tickets in resale transactions.
4. If the Office of the Attorney General determines that lottery ticket resale transactions are legal under current state law, the General Assembly should amend state law to explicitly prohibit the practice.

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## State Law Inadequate Regarding the Withholding of Lottery Prizes to Pay Past Due Taxes, Child Support, and Other Debts

When lottery prizes are \$5,000 or greater, South Carolina law requires that the winnings be withheld to settle certain debts of \$100 or more owed by prize winners where the state is either the creditor or a collection agent for creditors. These debts could include but would not be limited to past due taxes, student loans, child support, and other court-ordered payments.

Lottery prizes of \$5,000 and greater in South Carolina, however, comprise 0.003% of total lottery prize winnings in the state. As a result, creditors may not benefit from lottery prizes under \$5,000 received by debtors.

In North Carolina and Tennessee, when lottery prize winnings are \$600 and greater, these winnings are withheld to settle debts greater than \$50 and \$100, respectively. In Florida, when lottery prize winnings are greater than \$600, these winnings are withheld to settle a debt of *any* amount.

If South Carolina were to lower its withholding threshold to \$500, total lottery receipts potentially subject to withholding would increase from approximately 17,000 individuals to 124,000 individuals.

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## Recommendation

5. The General Assembly should amend state law to require the withholding of lottery prize winnings greater than \$500 to settle debts of any amount owed by prize winners where the state is either the creditor or a collection agent for creditors.

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## **Inadequate Oversight of Retailers Regarding the Purchase of Winning Tickets**

Because SCEL does not interpret state law as prohibiting the resale of lottery tickets, it does not attempt to discourage or otherwise prevent the practice by regular players. SCEL, however, does take steps to enforce its contractual prohibition against retailers purchasing winning lottery tickets from customers for less than the prize amounts won by the customers.

The agency enforces this contractual provision through undercover checks, called compliance checks, and other types of reviews and investigations of its retailers.

SCEL, however, has not formalized a policy initiating extra scrutiny of tickets redeemed by retailers and their employees to ensure the tickets were obtained in compliance with their contracts. We found that several lotteries have policies that apply greater scrutiny to the tickets redeemed by retailers, their employees, and their household family members to ensure that these individuals obtained the tickets through legitimate play.

We also found that none of the enforcement mechanisms used by SCEL regarding its retailers have been formalized and that SCEL could strengthen the mechanisms it does use to better assess whether retailers are purchasing winning tickets from customers for less than the prize amounts won.

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## **No Policy Requiring Extra Scrutiny of Prize Claimants with Greater Access to Lottery Tickets**

SCEL's contract is not clear regarding individuals affiliated with retailers are prohibited from purchasing winning tickets from customers for less than the prize amounts won.

In addition, SCEL does not have a policy regarding the enforcement of this prohibition. Several other lotteries have implemented policies requiring extra scrutiny of prize claims made by retailers, employees, or retailers' household family members, and audits of state lotteries have also recommended similar policies. Sometimes referred to as "insider" policies, these policies outline a separate, more stringent process that is initiated when processing claims of retailer-related individuals. These policies typically:

- Define the parties to whom the prohibition applies.
- Establish thresholds, such as prize amounts and/or number of tickets.
- Outline various procedures to be followed depending on the:
  - Proximity of the claimant to a retailer.
  - Prize amount of the winning ticket.
  - Number of winning tickets claimed in a given period.



### **Defining Insiders and Agents**

Lotteries in North Carolina, Ohio, Ontario, and British Columbia have defined an “insider” as a retailer or employee, and still others include the household members of retailers.

In SCEL’s retailer contract, the term “agent” is not defined. If an agent is an individual who acts on behalf of another, then spouses, children, and other relatives who assist retailers and their employees in the purchase and redemption of lottery tickets could be considered agents. Clarification of the term “agent” would make the contract less ambiguous.

### **Identifying Insiders**

To determine retailer-related statuses, other lotteries may rely on self-reported information from the claim form, or claim center staff may automatically check the claimant’s information against their retailer database.

SCEL’s form for claiming prizes does not require a claimant to self-identify as a retailer, employee, or a household family member of a retailer nor do staff check a claimant’s status prior to awarding a prize. Rather, it is only after a claim is paid that SCEL checks a claimant against their retailer database. SCEL’s newly implemented information system, however, provides notification to staff when claimants previously identified as *suspect* have submitted tickets through the claims center for redemption. It is important to note that suspect claimants are not exclusively retailers nor are they inclusive of all retailers.

Furthermore, the method used to detect retailers cannot be used to detect retail employees. SCEL does not have a database of most retail employees and, therefore, generally has no means of knowing if a claimant is also a retail employee (see *Inadequate Data on Retailers’ Employees and Household Members*).

### Establishing Thresholds

Lotteries in other states have established the following prize value thresholds for tickets redeemed by retailer-related individuals in which an interview is warranted.

- The Arkansas Lottery requires retailers and their employees claiming prizes greater than \$500 to be interviewed.
- The British Columbia Lottery's claims center staff conduct interviews with retailer-related claimants who redeem tickets with prizes between \$2,000 and \$10,000. For tickets with prizes greater than \$10,000, British Columbia Lottery security staff conduct an additional face-to-face interview.
- The Ohio Lottery conducts interviews of retail-related claimants who redeem tickets with prizes greater than or equal to \$10,000, and an agency investigator to conducts the interview.
- The Ontario Lottery and Gaming Corporation (OLG) conducts interviews of *any* prize claimant, regardless of their status as or connection with a lottery retailer, who redeems a ticket with a prize greater than or equal to \$10,000. These interviews are conducted in person by OLG specially trained security staff.

Based on the dollar thresholds used by other lotteries and SCEL claimant data from November 2016 through November 2017, Table 3.2 shows the number of retailer interviews SCEL would have had to conduct if it had implemented similar thresholds.

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**Table 3.2: Number of  
Retailer-Related Claimants\*  
SCEL Would Have Interviewed  
Using Prize Value Thresholds  
from Other Lotteries,  
November 2016–November 2017**

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PRIZE VALUE THRESHOLDS			
ARKANSAS >\$500	BRITISH COLUMBIA >\$2,000	OHIO ≥\$10,000	ONTARIO ≥\$10,000
260	83	10	10

\* Includes SCEL retailers and select retail managers called operational managers.

Sources: Arkansas, British Columbia, Ohio, and Ontario lottery security measures

### **Procedures for Giving Extra Scrutiny to Retailer-Related Claimants**

While lotteries we reviewed generally prefer to keep the specific questions of their investigative interviews confidential, lottery procedures we reviewed generally involve asking the claimant to identify the date, time, and place of purchase, among other items. Some lotteries conduct these interviews before prize payment is authorized.

### **Penalties Unknown**

SCEL's retailer contract does not provide a specific schedule of penalties for violating the agency's ban against purchasing winning tickets for less than the prizes won. In broad terms, the document states that a contract violation may result in the revocation or suspension of a retailer's license. This language, however, provides no real guidance for SCEL, the offender, or the public regarding the specific type and length of penalty warranted.

It is also unclear whether SCEL intends to penalize a retailer, retail employee, and an agent in the same manner for violating this provision. By extension, retail employees and retailers' agents are acting on behalf of SCEL, and their behavior affects the integrity of SCEL as much as a retailer's behavior. In North Carolina, the penalties vary depending on whether the individual is a retailer, retail employee, or a member of the retailer's household and if the retail owner is found to have no involvement.

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## **Undercover Retailer Compliance Check Process and Results**

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Compliance checks are one type of enforcement measure SCEL uses to assess retailer compliance with the prohibition on purchasing winning tickets from customers for less than the prize amount won. Below we summarize the process, its results, and opportunities for improvement.

### **Process**

From October 2014–April 2015, SCEL conducted its first and, thus far, only round of compliance checks. These checks were intended to determine if the retailer or employee would:

- Offer to pay prize winners discounted rates for their winning tickets.
- Steal winning tickets while identifying them as losing tickets or paying out less than the prize value.

A total 382 retailers, or approximately 10% of SCEL's retail stores at the time, were visited. Stores were selected based on a history of complaints by players and the public and/or other suspicious behaviors. There was an effort to check retailers from all areas of the state and all retailer types.

## **Results**

SCEL found three retail stores whose retailers or retail employees participated in the purchase of winning tickets for less than the prize amounts won. For three of the retailers, SCEL revoked their licenses.

According to SCEL, a retail employee at a fourth location misrepresented the value of a winning ticket to a customer as less than the actual value, and then presented the ticket at the claims center to redeem the full winning value. While the employee was criminally charged with lottery fraud, SCEL did not suspend or revoke the retailer's license because it was determined that the employee was involved and acted without the knowledge of the retailer. According to SCEL, an employee at another retail location kept the winning ticket but made no attempts to claim the prize. SCEL did not cite the retailer or take action against the employee because the agency determined that it was an inadvertent error on the part of the employee.

It would be improper to extrapolate the findings of these compliance checks to the agency's network of retailers, as the sample of retailer stores visited was not randomly selected.

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## **Potential Improvements for Undercover Retailer Compliance Checks**

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SCEL's undercover compliance check process could be improved. It is important to note that we do not address some of the details of SCEL's compliance check process in this report so that future checks may continue to occur using methods that have not been publicized.

### **Conducting Ongoing Compliance Checks**

Continual, ongoing checks of retailers may better identify retailers and retail employees who have purchased winning tickets from customers for less than the prize amounts won, and give regular lottery customers assurance that retailers and their employees are complying with state law and agency requirements. When compliance checks occur less frequently than once a year, retailers may become aware of the periods of reduced oversight, whereas continual, ongoing checks — such as monthly or yearly — may be less predictable.

SCEL has conducted only one round of compliance checks to date, in calendar years 2014–2015. While the agency intends to conduct additional rounds of compliance checks in the future, SCEL staff have stated that ongoing checks of retailers are not necessary because SCEL does not receive many complaints and has few issues with its retailers. SCEL officials also stated that, because South Carolina has fewer retailers than other states, there is not a need for continual checks.

There may, however, be a bias to the complaints received by SCEL, as they were not obtained through random sampling. So, while SCEL records indicate few issues relating to the purchase of winning tickets by retailers, it would be inaccurate to assume that the degree to which complaints occur is reflective of the number of retailer issues.

Florida's lottery conducts retailer compliance checks monthly, while Colorado's lottery conducts checks annually.

Independent of SCEL, local South Carolina law enforcement agencies under contract with the S.C. Department of Alcohol and Other Drug Abuse Services primarily conduct underage checks of alcohol and tobacco products annually.

### **Varying Undercover Agents to Reflect the Retailer's Demographics**

The same undercover agent was the primary agent on most of the compliance checks conducted. This may tip off a retailer that he was undergoing a check. Retailers already visited could inform other retailers scheduled to be visited later.

Local law enforcement in South Carolina responsible for checking retailers for underage sales of alcohol and tobacco have made efforts to use undercover agents that fit the retailer's customer demographics. There have also been efforts to vary the sex and age of the undercover agents.

### **Varying the Approach from Store to Store**

The methods used by SCEL's undercover agent were the same for each of the 382 retail stores. The predictability of the checks could expose the agency's methods, where retailers already visited could inform other retailers scheduled to be visited later.

### **Using a Suggestive Approach**

It has not been agency policy or practice for the undercover agent to attempt to sell a winning ticket to a retailer or their employee. Retailers and their employees may be less likely to initiate discussion of a resale transaction with individuals who are unfamiliar. Having the undercover agent offer a winning ticket to the retailer at a discounted rate rather than relying on the retailer to do so may be more indicative of the retailer's willingness to purchase winning tickets.

### **Publicizing the Results of the Compliance Checks**

SCEL generally does not publicize the results of its compliance checks to maintain the confidentiality of the process.

Publicizing the results of these checks may be a deterrent to retailer misconduct and boost public confidence regarding the integrity of the games by demonstrating SCEL's efforts to ensure that retailers comply with state laws and contracts.

#### **OTHER JURISDICTIONS**

In our review of other lotteries, we found that Florida, Ohio, and California report the results of their compliance checks in the form of press releases on their websites. Local law enforcement in South Carolina not only publish the results of their undercover operations but also advertise that these checks are occurring.

#### **OTHER GOVERNMENT AGENCIES**

The S.C. Department of Health and Environmental Control has a searchable database for the results of its restaurant inspections by establishment, and the Centers for Medicare and Medicaid Services have a searchable database for nursing home ratings. Both of these databases not only provide ratings but the reasons for noncompliance, when appropriate.

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### **Investigations of Retailers with a High Number of Tickets Redeemed**

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Separate from a compliance check, SCEL conducts reviews and investigations of retailers who redeem a high number of tickets in a given period to determine if they have purchased winning tickets from customers. While these investigations also include non-retailers, they are not generally the focus of these investigations.

An investigation often includes researching where a retailer's recently-redeemed tickets were originally purchased and where those tickets were scanned to determine if they were winners. SCEL may then interview any retailers involved with the tickets, the purchasers of the tickets, and the individuals redeeming the tickets. The investigators will also review video footage of the ticket purchase, when available.

SCEL investigations, however, do not include probability analysis of the winning patterns for the persons being investigated. This information would be a useful resource for SCEL (see *Probability Analysis of Frequent Prize Claiming Patterns of Retailers and Other Players*).

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## Recommendations

6. The South Carolina Education Lottery should amend its retailer contract regarding the prohibition against purchasing winning lottery tickets for less than the prize amounts by defining the parties to whom it applies.
7. The South Carolina Education Lottery should develop a formal policy regarding the measures it uses to enforce its prohibition against retailers purchasing winning lottery tickets for less than the prize amounts.
8. The South Carolina Education Lottery should require lottery retailers, employees, and retailers' household family members to identify as such on the claim form when redeeming a winning lottery ticket.
9. The South Carolina Education Lottery should, prior to paying claims, automatically check to determine whether the prize claimants are active lottery retailers or associated with lottery retailers.
10. The South Carolina Education Lottery should conduct its undercover checks of retailers' compliance with state law and contract using a continual schedule that minimizes the chance the retailers will know when a check is more likely to occur.
11. The South Carolina Education Lottery should conduct more robust retailer undercover compliance checks for the purchase of winning tickets by implementing the following:
  - Use of undercover agents who reflect the demographics of the retailers' customers.
  - Use of undercover agents from populations that are more vulnerable to retailer misconduct.
  - Varying the process from store to store.
  - Use of a suggestive approach.
  - Publicizing disciplinary actions on its website.

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## **Probability Analysis of Frequent Prize Claiming Patterns of Retailers and Other Players**

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### **Reasons Given for Frequent Prize Claims**

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SCEL has routinely identified, reviewed, and investigated frequent prize claimants who are retailers.

The agency has not, however, used statistical probability analysis when assessing whether retailers or other players with frequent prize claims purchased their tickets in compliance with state laws, regulations, and contracts. Based on our analysis, we found it improbable that any person in the state could have won through legitimate play as frequently as many of these claimants.

There are several reasons given that explain why individuals have frequent prize claims, including the following:

- Individuals with frequent prize claims may have purchased the winning tickets from other players. Some players may sell their winning tickets to avoid the withholding of their winnings by the lottery or to avoid the reporting of their winnings to state and federal tax agencies, social services agencies, or the court system due to debts such as past due child support and taxes.
- Some frequent prize claimants may purchase a lot of tickets. However, the probability of winning decreases as the value of the prize increases. Winning multiple, larger prizes — prizes greater than \$500 — is improbable, even for those who purchase a lot of tickets.
- A person may win by playing the same numbers in a draw game, such as Pick 3 or Pick 4, multiple times for a single drawing. A single event of this type is recorded as multiple wins and can give the appearance of frequent winning. It is important to note, however, that this type of winning occurs from playing a specific game at one point in time rather than winning multiple, different games over time.
- SCEL officials state that other players may sell their winning tickets due to a lack of transportation to the Columbia claims center. Prizes up to \$100,000 may be redeemed by mail without traveling to Columbia.



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## Overview of LAC Analysis

We reviewed SCEL data to identify frequent claimants, including retailers and regular lottery customers, from November 2008–November 2017.

It is important to note that the data available for our review was limited to individual prizes valued at more than \$500. As noted in Table 1.1 in Chapter 1, prizes greater than \$500 comprise 0.03% of prizes claimed during our review period (see *Process for Selling Lottery Tickets and Paying Out Prizes*). We did not assess the frequency of claims for prizes of \$500 or less, which represent 99.97% of all tickets redeemed during our review period.

We identified 244 retailers and other players who redeemed 20 or more tickets for lottery prizes greater than \$500 during our review period. Winning 20 lottery prizes greater than \$500 can be highly improbable, depending on the:

- Probability of winning the specific games for which prizes were won.
- Number of tickets purchased.
- Specific bets made on draw games (such as Pick 3, Pick 4, Powerball, etc.).
- Extent to which players have won draw games by betting the same numbers multiple times for single draws.

Of the 244 individuals who redeemed 20 or more tickets, we focused on the 18 individuals who redeemed 50 or more tickets.

For these 18 individuals, we assessed the probability of any resident of the state of South Carolina winning prizes as frequently as these claimants, 5 of whom were current or former retailers.

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## Inadequate Data on Retailers' Employees and Household Members

We were unable to identify all claimants employed by or related to retailers. These individuals may have greater access to tickets than regular lottery customers, and as such, have greater opportunities to engage in misconduct with tickets.

### **Retailers and Operational Managers**

SCEL maintains a database of retailers and a certain type of manager called an operational manager. Retailers include owners, partners, members, directors, and/or officers. Operational managers are responsible for the day-to-day management of a retailer's lottery operation, such as placing ticket orders. Retailers and operational managers, however, may not always work on-site at a retail store, and in cases where they do, it is unlikely that they exclusively are involved in the selling and redeeming of tickets to players.

### **Other Retail Employees and Retailers' Household Family Members**

SCEL does not maintain a database of certain retail employees, such as store managers, when they are different from the operational manager and clerks. These individuals may handle tickets as much as, or more than, some retailers and operational managers.

SCEL also does not maintain a database of retailers' household family members. Retailers may deflect attention for questionable claiming patterns by spreading out the number of redeemed tickets among several family members. SCEL could develop a database of retailers' employees and household family members in several ways.

- Require retailers and their employees to register through the lottery terminal. According to the Ontario lottery retailer manual, the lottery “requires [reporting] the identity of *all* persons who are involved in the sale or redemption of lottery tickets....” [Emphasis added.]
- Require retailers' employees and household family members to identify as such when claiming prizes.

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## Recommendations

12. The General Assembly should amend state law to authorize the South Carolina Education Lottery to collect information identifying lottery retail employees in order to maintain a database of individuals who have greater incentive to engage in misconduct with lottery tickets.
13. The South Carolina Education Lottery should develop and renew annually a database that includes all employees of lottery retailers.

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## Probability Analysis of Claimants Who Redeemed 50 or More Winning Tickets

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For the 18 individuals who redeemed 50 or more winning tickets, we conducted formal probability analysis with assistance from Professor Philip Stark, an expert in frequent lottery claiming patterns and a statistician at the University of California, Berkeley. We found it improbable that any person in the state could have won through legitimate play as frequently as many of these claimants.

As shown in Table 3.3, we calculated the minimum amount that every resident of South Carolina would have to spend on lottery games over 9 years for any one of them to have a 1-in-10 million chance of winning as often as each particular frequent claimant in the table. This analysis was based on conservative assumptions, producing results that are understated (see Appendix B).

It is important to note that, prior to our review, SCEL had also identified these frequent claimants. The agency had not, however, quantified the improbability of their claiming patterns. The improbability of frequent claiming patterns is not necessarily an indication of wrongdoing by retailers or players but could be used as a resource when:

- Identifying, monitoring, and investigating frequent prize claimants.
- Banning individuals with the most improbable prize claiming patterns from claiming prizes for a fixed amount of time in the future (see *Penalties for Individuals in Massachusetts Who Redeem Winning Tickets at Improbable Rates*).

**Table 3.3: Probability Analysis of Claimants Who Redeemed 50 or More Winning Tickets, November 2008–November 2017**

CITY OF RESIDENCE OF THE CLAIMANT	TICKETS REDEEMED	TOTAL PRIZE AMOUNT	NUMBER OF INDEPENDENT TICKETS ANALYZED*	CONSERVATIVE ESTIMATES OF THE MINIMUM EVERY RESIDENT OF S.C. WOULD NEED TO SPEND FOR A 1-IN-10 MILLION CHANCE THAT ANY OF THEM WOULD WIN AS FREQUENTLY AS THE CLAIMANT**
Simpsonville	61	\$85,765	53	\$2,061,263
Lamar	118	\$217,540	111	\$1,019,748
Charleston-B	122	\$205,014	102	\$797,224
Lake City	62	\$71,994	54	\$389,847
Charleston-A	125	\$289,045	77	\$317,257
Charleston-C	59	\$83,594	45	\$224,546
Georgetown	80	\$202,273	46	\$171,228
Sumter	92	\$129,040	71	\$127,055
Kingstree	51	\$63,410	35	\$124,358
Hanahan	53	\$130,015	36	\$120,587
North	90	\$125,080	66	\$69,405
Summerville-B	55	\$116,820	50	\$62,043
Belton	53	\$237,600	37	\$59,387
Summerville-A	85	\$52,600	81	\$39,991
Bamberg	50	\$97,000	16	\$32,102
Effingham	51	\$57,000	39	\$23,618
Mount Pleasant	50	\$49,200	41	\$15,586
Longs	113	\$461,800	3	N/A***

Notes: Retailers active during or prior to December 2017 appear in **green**.

The Lamar claimant is also referenced in Table 3.9 for the Darlington County store, while the Georgetown claimant is referenced in Table 3.8 for the Chesterfield County store.

\* To account for data limitations on draw game tickets, we made conservative assumptions that resulted the number of winning tickets in our analysis being less than the number of winning tickets redeemed. The net effect of our assumptions was a conservative calculation of the minimum spend amounts.

\*\* Based on a U.S. Census Bureau estimated that S.C. had 5,024,369 residents as of July 1, 2017.

\*\*\*This frequent claimant had three distinct wins due to claiming a significant number of prizes on only three different days. As a result, the lowest spend amount for this claimant was \$3, which gives a minimum probability of 5-in-1 million.

Source: LAC analysis of SCEL claimant data. Data available for our review was limited to redeemed tickets greater than \$500.

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**SCEL Investigations  
of Retailers  
Who Redeemed  
50 or More  
Winning Tickets**

For the current or former retailers identified in Table 3.3, SCEL has conducted an investigation of each for having a high volume of claims. The following are the results of these investigations.

**Simpsonville Claimant**

A 2015 SCEL investigation found that this retailer claimed a prize for a winning ticket that s/he did not originally purchase. An investigative report from the South Carolina Law Enforcement Division (SLED) indicated that the attorney for this retailer stated that the retailer paid a lottery player \$2,000 for a winning ticket with a prize of \$2,600.

SCEL records from calendar years 2015–2017 show that this retailer was not cited for any violations associated with a resale transaction and had an active license to sell tickets as of December 2017. This retailer had an active lottery license during the time s/he redeemed all 61 tickets.

Every resident of South Carolina would need to spend over \$2 million over 9 years on lottery tickets — nearly \$230,000 per year — for there to be a 1-in-10 million chance that any of them would win as frequently as this retailer. This also means that nearly \$10.4 trillion would need to be spent on lottery games statewide for there to be a remote possibility of anyone winning as frequently as this individual. For comparison, total SCEL revenue from FY 08–09 through FY 16–17 was only around \$11.3 billion.

**Lamar Claimant**

A 2015 SCEL investigation found that this retailer admitted to purchasing winning tickets for less than the prize amounts, but also described a pattern of frequent legitimate ticket purchasing.

SCEL’s 2015 investigation notes indicate that it found three individuals who admitted selling their winning tickets to the retailer, including a player who reported selling a \$5,000 ticket to the retailer for \$3,000. The investigation notes also indicate that the retailer had:

... submitted thirty (30) separate claims to SCEL in fourteen (14) months for \$66,923.00. SCEL also knew that some of the tickets submitted by [the retailer] were tickets that were purchased by SCEL players, who allowed [the retailer] to purchase the tickets for an amount significantly lesser [sic] than the winning prize value.

In addition, SCEL records from calendar years 2015–2017 show that this retailer was not cited for any violations and had an active license to sell tickets as of December 2017. However, it was not until September 2018 that SCEL revoked this retailer’s license because of the store’s involvement in a resale transaction. This retailer had an active lottery license during the time s/he redeemed all 118 tickets.

Every resident of South Carolina would need to spend over \$1 million over 9 years on lottery tickets — over \$113,000 per year — for there to be a 1-in-10 million chance that any of them would win as frequently as this retailer.

#### **Charleston-C Claimant**

In 2015, SCEL reviewed the high-volume claims submitted by this retailer; the agency continues to monitor claims submitted by this individual. SCEL records from calendar years 2015–2017 show that this retailer was not cited for any violation and had an active license to sell tickets as of December 2017. This retailer had an active lottery license during the time s/he redeemed all 59 tickets.

Every resident of South Carolina would need to spend nearly \$225,000 over 9 years on lottery tickets — nearly \$25,000 per year — for there to be a 1-in-10 million chance that any of them would win as frequently as this retailer.

#### **Charleston-B Claimant**

This person was a former retailer when a SCEL investigation was initiated in 2014. This former retailer admitted to participating in resale transactions, but SCEL has not penalized this person for this activity. This retailer had an active lottery license during the time s/he redeemed 6 of her/his 122 tickets.

Every resident of South Carolina would need to spend nearly \$800,000 over 9 years on lottery tickets — nearly \$89,000 per year — for there to be a 1-in-10 million chance that any of them would win as frequently as this former retailer.

#### **Georgetown Claimant**

In 2012, SCEL reviewed the high number of claims submitted by this retailer who, soon after, had her/his license revoked for not having sufficient funds (NSF) to pay her/his lottery obligations. This retailer had an active lottery license during the time s/he redeemed 65 of her/his 80 tickets.

Every resident of South Carolina would need to spend over \$171,000 over 9 years on lottery tickets — over \$19,000 per year — for there to be a 1-in-10 million chance that any of them would win as frequently as this former retailer.

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## Probability Analysis of Claimants Who Redeemed Between 20 and 50 Winning Tickets

In some instances, redeeming fewer than 50 winning tickets can be as improbable as redeeming 50 or more winning tickets. This potential can exist when the probability against winning are greater for the tickets redeemed by the individual who has redeemed fewer tickets.

Table 3.4 contains three examples of claimants with fewer than 50 winning tickets who have minimum spend amounts comparable to those of the claimants with more than 50 winning tickets listed in Table 3.3.

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**Table 3.4: Examples of Claimants  
Who Improbably Redeemed  
Between 20 and 50  
Winning Tickets**

TICKETS REDEEMED	TOTAL PRIZE AMOUNT	MINIMUM SPEND AMOUNT	MINIMUM SPEND AMOUNT RANK IF INCLUDED IN TABLE 3.3
44	\$477,423	\$377,529	5 <sup>th</sup>
34	\$353,704	\$129,431	8 <sup>th</sup>
25	\$144,410	\$146,455	8 <sup>th</sup>

Source: LAC analysis of SCEL claimant data. Data available for our review was limited to redeemed tickets greater than \$500.

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## Number of Stores from Which Tickets Redeemed by Claimants Were Purchased

In addition to analyzing the winning patterns of SCEL's frequent claimants, we reviewed the number of different stores that sold winning tickets to the claimants.

SCEL also reviews similar information when reviewing or investigating individuals with high-volume claims but does not quantify the improbability of their claiming patterns.

When a person claims prizes for tickets purchased from a high number of different retailers, this can be an indication that the claimant did not purchase them from the stores but purchased known winning tickets from third parties.

Table 3.5 summarizes this information for SCEL's frequent claimants.

**Table 3.5: Number of Stores from Which Claimants Who Redeemed 50 or More Winning Tickets Purchased Their Tickets, November 2008–November 2017**

PRIZE CLAIMANTS' CITY OF RESIDENCE	NUMBER OF	
	TICKETS REDEEMED	DIFFERENT STORES WHERE REDEEMED TICKETS WERE PURCHASED
Charleston-B	122	90
Charleston-A	125	53
Lamar	118	52
Lake City	62	36
Charleston-C	59	34
Kingstree	51	34
Simpsonville	61	33
Sumter	92	29
North	90	26
Summerville	85	26
Effingham	51	19
Belton	53	17
Summerville-B	55	16
Mount Pleasant	50	13
Hanahan	53	10
Bamberg	50	7
Georgetown	80	4
Longs	113	3

Note: Retailers active during or prior to December 2017 appear in **green**.

Source: LAC analysis of SCEL claimant data. Data available for our review was limited to redeemed tickets greater than \$500.

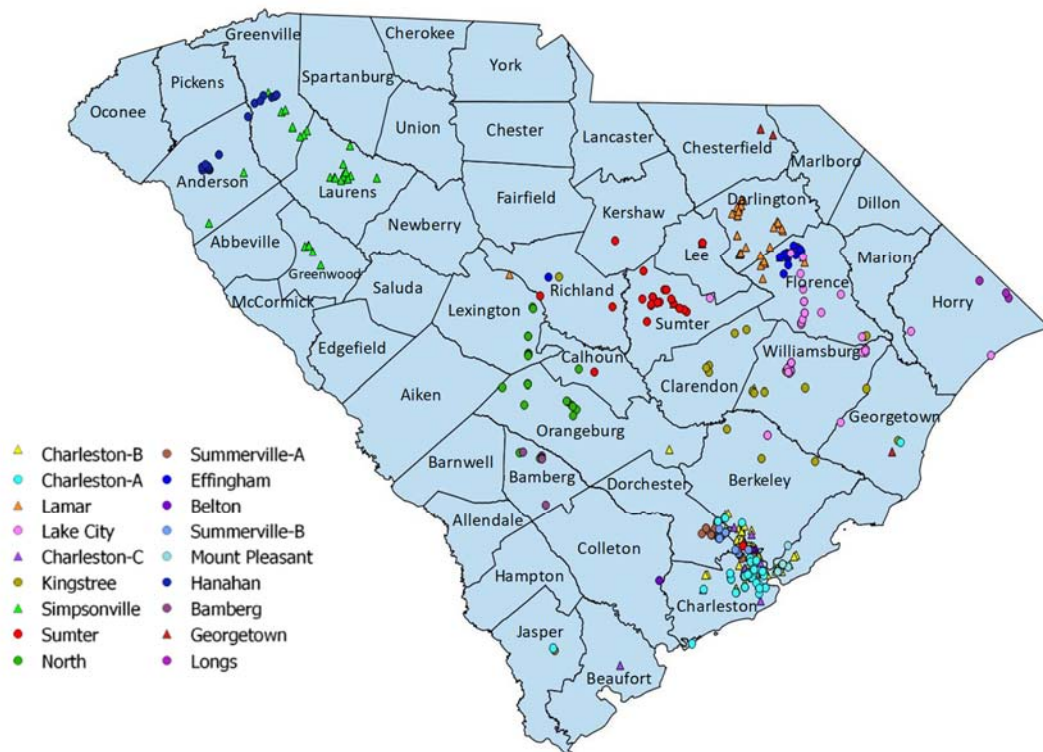
Tickets redeemed by the Charleston-B claimant, who is a former retailer, were purchased from 90 different retail stores. During a 2014 SCEL investigation, this person stated s/he redeemed winning tickets for others, usually older individuals because they do not have vehicles or means to go to the claims center in Columbia. It is important to note that for prizes \$100,000 or less, winning tickets can be mailed to the claims center in Columbia for redemption. This person also claimed to charge the original purchaser of the tickets 5% of the prize amount and enough for taxes.

There was, however, no evidence corroborating Charleston-B's reason or service charge in SCEL's files. It is our interpretation of state law that transferring known winning tickets in exchange for money is illegal. SCEL, however, does not regard the resale of winning tickets to be an illegal practice, and this individual was not penalized for engaging in these transactions (see *Resale of Winning Lottery Tickets May Violate State Law*).



Figure 3.6 shows all of the retail stores that originally sold the winning tickets redeemed by each frequent claimant in our analysis. Each color on the map represents a single prize claimant, and each dot represents a different store. Of these frequent claimants, several have claimed prizes for tickets purchased in as many as four different counties. An individual claiming prizes for tickets originally purchased from a large number of retail stores over a wide geographic area may be an indication that they are involved in resale transactions.

**Figure 3.6: South Carolina's 18 Most Frequent Claimants and the Stores Where Their Tickets Were Purchased, November 2008 – November 2017**



Notes: Each color represents a single prize claimant, while each shape represents a store where a winning ticket was purchased. Triangles represent current or former retailers as of December 2017. Circles represent regular lottery players.

Source: LAC analysis of SCEL claimant data. Data available for our review was limited to redeemed tickets greater than \$500.

A 2015 SCEL investigation of the Lamar claimant — indicated on Figure 3.6 with orange triangles — found that this retailer reported purchasing winning tickets from third parties but also reported purchasing tickets legitimately from multiple stores (see *SCEL Investigations of Retailers Who Redeemed 50 or More Winning Tickets*). As evidence of frequent play, this retailer provided a photograph showing stacks of tickets played. A retailer, however, could easily collect losing tickets from customers. Similar to winning tickets, individuals may sometimes purchase losing tickets to obtain the gambling loss deduction on income taxes that is allowed by the federal government. This retailer’s license was revoked in September 2018, for an employee’s participation in a resale transaction.

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## Recommendations

14. The South Carolina Education Lottery should routinely conduct statistical probability analysis of the prize claiming patterns of players who frequently redeem winning tickets with larger prizes to determine whether it would be probable for any person to win as frequently. It should use the results of this analysis as a basis for and a component of further investigation.

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## Prizes Claimed by Affiliated Individuals

We reviewed SCEL data for winning patterns that occurred among individuals affiliated by mailing address and individuals affiliated by retail store. Some players may spread out their prize claims among two or more individuals to avoid suspicion. We found several instances where affiliated individuals — both retailers and regular lottery customers — who, combined, had frequent claiming patterns.

SCEL also reviews this information during reviews or investigations of individuals with a high number of claims but does not quantify the improbability of their claiming patterns.

Implementing the recommendations in this report may decrease the number of *individuals* with improbable winning patterns, as found in Table 3.7, and increase the number of *affiliated individuals* with improbable winning patterns. To avoid detection, individuals participating in the purchase of winning tickets may be forced to spread out their prize claims among others. This increases the number of individuals involved in the transaction, which may decrease the profits once earned by an individual and increases the chances that members of the group may expose the scheme.

Having knowledge of the affiliations between claimants would help in detecting individuals who work with other individuals to redeem winning tickets (see *Inadequate Data on Retailers' Employees and Household Members*).

#### Frequent Claimants with the Same Address

SCEL's prize claim form requires, among other things, a claimant's mailing address. We reviewed SCEL data from November 2008 through November 2017 to determine if two or more non-retailer individuals with the same mailing address redeemed 50 or more tickets greater than \$500 and found three pairs of individuals.

Table 3.7 summarizes the top three pairs of claimants with the same claimant address by total number of tickets and total prize amount.

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**Table 3.7: Individuals with the Same Address Who Redeemed 50 or More Tickets Combined, November 2008–November 2017**

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PRIZE CLAIMANTS' CITY OF RESIDENCE	TICKETS REDEEMED	TOTAL PRIZE AMOUNT
Johns Island-A	27	\$16,200
Johns Island-B	24	14,400
TOTAL	51	\$30,600
Timmons ville-A	28	\$47,000
Timmons ville-B	26	33,280
TOTAL	54	\$80,280
Greer-A	44	\$477,423
Greer-B	6	14,400
TOTAL	50	\$491,823

Source: LAC analysis of SCEL claimant data. Data available for our review was limited to redeemed tickets greater than \$500.

Greer-A was unique because it included 2 tickets of \$200,000 each, with a winning probability of less than 1-in-400,000 for each ticket. However, after excluding those tickets, the combined probability of the remaining winning tickets remained extremely low.

SCEL reports that, to varying degrees, it has reviewed or investigated the individuals referenced in Table 3.7 but has not quantified the improbability of their claiming patterns. This information would be a useful investigative resource and could be used as evidence to suspend prize claiming privileges for individuals with highly improbable winning patterns.

#### **Frequent Claimants Affiliated by Retail Organization**

We also reviewed the total number of tickets redeemed by individuals employed at the same retail organization. This review was limited to current or former retailers and operational managers, as SCEL does not maintain a record of other types of retail employees.

We identified retail stores where both the retailer and operational manager claimed 4 or more winning tickets each and 20 or more winning tickets combined. We found 7 pairs or groups of retailers affiliated by retailer organization who had anywhere from 23–85 combined prizes claimed with total combined prize amounts ranging from approximately \$41,000–\$242,000. Table 3.8 summarizes the combined prize claims of these individuals.

SCEL also reviewed this information during reviews or investigations of high-volume claimants but did not quantify the probability of their claiming patterns.

**Table 3.8: Individuals Affiliated by Retail Organization Who Redeemed a Combined Total of 20 or More Winning Tickets, November 2008–November 2017**

COUNTY	NUMBER OF INDIVIDUALS AFFILIATED	TOTAL COMBINED	
		TICKETS REDEEMED	PRIZE AMOUNT
Chesterfield	2	85	\$218,573
Charleston	2	48	\$242,640
Beaufort	3	35	\$83,142
Dorchester	2	33	\$41,254
Anderson	2	33	\$59,154
Sumter	2	30	\$97,360
Spartanburg*	2	23	\$40,450

Notes: Retailers with an active license to sell tickets as of December 2017 appear in **green**.

One of the claimants affiliated with the Chesterfield County store is also the Georgetown claimant in Table 3.3. Both of the claimants affiliated with the Anderson County store are also referenced in Table 3.9.

\* This retailer has stores in multiple counties.

Source: LAC analysis of SCEL claimant data. Data available for our review was limited to redeemed tickets greater than \$500.

SCEL has reported that, to varying degrees, the agency has reviewed or investigated the individuals referenced in Table 3.8.

SCEL, however, has not calculated the probability of the prize claiming patterns for these affiliated individuals. It would be useful for SCEL to determine the probability of winning as frequently as these individuals.

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## **No Ban on Retailers and Their Employees from Buying Tickets Where They Work**

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### **Potential Consequences of Allowing Retailers and Their Employees to Buy Tickets Where They Work**

South Carolina does not ban retailers and their employees from purchasing tickets from their own stores. Such a ban would:

- Reduce the likelihood of retailers and retail employees purchasing winning tickets from customers for less than the prize amounts.
  - Create equity between regular lottery customers and retailers in the sale price of tickets.
- 

### **Easier to Participate in Resale Transactions**

Allowing retailers and their employees to purchase tickets from stores where they work makes it easier for them to participate in resale transactions.

### **Retailers Pay Less for Tickets**

State law requires SCEL to pay sales commissions to retailers. In addition, SCEL voluntarily pays bonuses to retailers who sold redeemed winning tickets for prizes \$10,000 or more.

Commissions reduce the effective price paid by retailers who purchase tickets from their own stores. For every ticket sold, a retailer receives a 7% commission, meaning a ticket that costs a regular lottery player \$1 effectively costs a retailer 93¢. Banning retailers from purchasing tickets where they work would create equity in the sale price for regular lottery customers and retailers.

Furthermore, SCEL provides a 1% incentive to any retailer who sells a redeemed winning ticket with a prize valued at \$10,000 or more; the incentive is capped at \$50,000. As with the commissions awarded to retailers, this financial incentive encourages retailers to purchase tickets from their own stores.

## South Carolina Stores Where Most of the Winning Tickets Have Been Redeemed by the Stores' Retailers and Employees

We reviewed the extent to which current or former retailers or their employees claimed prizes greater than \$500 for tickets that were purchased at their own stores. Since SCEL does not maintain a retail employee database, this information was primarily limited to current or former retailers and/or operational managers. Operational managers are not necessarily the on-site store managers (see *Inadequate Data on Retailers' Employees and Household Members*).

Table 3.9 lists 4 retail stores — Darlington, Anderson, Florence, and Aiken counties — whose current or former retailer or operational managers redeemed more than 50% of the total winning tickets purchased at the store where they worked; in one case, the combined totals came from the retailer and store employee. As of December 2017, each of these retail stores had an active license to sell tickets.

When a retailer and/or the retailer's employees redeem a high percentage of the winning tickets purchased from their store, it may suggest that winning tickets have been purchased from the store's customers.

**Table 3.9: Percentage of Stores' Winning Tickets — With Prizes Greater Than \$500 — That Were Redeemed by the Stores' Retailers or Their Employees, November 2008–November 2017**

COUNTY	PERCENTAGE OF THE STORE'S WINNING TICKETS THAT WERE REDEEMED BY THE STORE'S RETAILERS OR EMPLOYEES	PERCENTAGE OF THE PRIZE PAYMENTS FOR THE STORE'S WINNING TICKETS THAT WERE RECEIVED BY THE STORE'S RETAILERS OR EMPLOYEES
Darlington	88.89% (48/54)	90.95%
Anderson	76.74% (33/43)	63.42%
Florence	60.98% (25/41)	79.78%
Aiken	54.55% (6/11)	67.12%

Notes: Totals from two or more individuals appear in orange.

One of the claimants affiliated with the Darlington County store is the Lamar claimant referenced in Table 3.3.

Both of the claimants affiliated with the Anderson County store is the Anderson County pair referenced in Table 3.8.

Source: LAC analysis of SCEL claimant data. Data available for our review was limited to redeemed tickets greater than \$500.

### **Darlington County Store**

The Darlington County store was an extreme case in our analysis. Over the 9-year period of our review, the Darlington County store sold 54 winning tickets with prizes greater than \$500. The combined total prize amount of these winning tickets was \$154,631. The retailer and employee combined redeemed 89% (48 of 54) of the winning tickets and 91% (\$140,631 of \$154,631) of the total prize amount sold by the Darlington County store.

Only 11% (6 of 54) of all winning tickets with prizes greater than \$500 that were sold by the Darlington County store were redeemed by individuals who did not work there. And, only 9% (\$14,000 of \$154,163) of the total prize amount sold by the Darlington County store was claimed by individuals who did not work there. As of December 2017, this retailer had an active license to sell tickets. However, in September 2018, SCEL revoked this retailer's license for the involvement of a store employee in the purchase of winning tickets.

SCEL has not calculated the probability of the winning pattern of retail staff who work together. It could be a useful resource to SCEL to identify one or more individuals who redeemed a high percentage of the total winning tickets sold by the store at which they worked and then calculate probability of their winning pattern to identify individuals who may be involved in resale transactions.

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### **Lotteries and Businesses Outside South Carolina that Prohibit Retailers and Employees from Buying Tickets Where They Work**

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A review of other state and provincial lotteries and lottery audits shows that some lotteries have implemented, and auditors have recommended, prohibiting retailers and their employees from purchasing lottery tickets from stores where they work.

Indiana has a statutory ban on retailers, employees, and household family members of retailers from purchasing tickets from the store where the retailer is authorized to sell them. In September 2018, the Vermont lottery banned lottery retailers and their employees from playing scratch-off tickets where they work. Lotteries in Ontario and British Columbia also have policies banning retailers and employees from purchasing lottery tickets from where they work. Massachusetts and North Carolina lotteries have informal policies that strongly discourage ticket purchases from the stores where they work. And, auditors in Iowa and Massachusetts have both recommended that their lotteries establish policies that ban retailers from purchasing lottery tickets from the stores where they work.



Enforcing such a ban involves monitoring retailer activity during slow periods when sales are unlikely and during the claims process and surveilling businesses with questionable patterns. For lotteries with retailer, retail employee, and retailer family member databases, checks are made during the claims process to determine if the claimant is a retailer or a retail employee and where the ticket was sold; further investigation is conducted if a claimant meets these criteria.

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## **Penalties for Individuals in Massachusetts Who Redeem Winning Tickets at Improbable Rates**

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In July 2018, the Massachusetts Lottery enacted a regulation authorizing it to conduct internal reviews:

... to determine if the submission of at least 20 claims for Lottery prizes, each with a value of at least \$1,000.00, within any period of 365 days, is factually or statistically improbable.

If the Lottery finds prize-claiming patterns that are improbable, it may temporarily suspend the future claims of these individuals for winning tickets valued at \$600 or more as follows:

- FIRST OFFENSE — up to a 90-day suspension.
- SECOND OFFENSE — up to a 180-day suspension.
- THIRD OFFENSE — up to a 365-day suspension.

There are at least two points to consider if South Carolina were to develop such a policy — public communication and penalty length. The violation and penalty would need to be properly communicated to the public. This could be accomplished by adding language to tickets, posting signage at retailer stores, adding this information on the agency's website, and its regulations. Also, in determining the penalty length, there should be some consideration that some lottery games may be played 14 days in advance, and that winning tickets may be redeemed up to 180 days after the end of the game.

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## Recommendations

15. The South Carolina Education Lottery should routinely conduct statistical probability analysis of pairs or groups of claimants who are affiliated and who frequently redeem winning tickets with larger prizes to determine how probable it would be for any pair or group to win as frequently.
16. The General Assembly should amend state law to ban lottery retailers, retail employees, and household family members of retailers from purchasing tickets from the retail stores at which they or their relatives work.
17. If the General Assembly does not amend state law to ban lottery retailers, retail employees, and household family members of retailers from purchasing tickets from the retail store at which they or their relatives work, the South Carolina Education Lottery should establish such a ban.
18. The South Carolina Education Lottery should establish enforcement measures to ensure that retailers, retail employees, and household family members of retailers comply with a ban on purchasing, validating, and redeeming tickets from the retail stores at which they or their relatives work.
19. The General Assembly should amend state law to require the suspension of prize claiming privileges of individuals with frequent and highly improbable prize claiming patterns.
20. If the General Assembly implements recommendation 20, the South Carolina Education Lottery should promulgate regulations with:
  - Standards for determining highly improbable prize claiming patterns.
  - A specified penalty structure.

# Enforcement of Other Laws and Policies Regarding Retailer Misconduct

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We reviewed state law, regulation, and the South Carolina Education Lottery's (SCEL) policies and practices related to retailer misconduct regarding issues other than the reselling of winning tickets, including:

- Cash payment for tickets.
- Selling tickets to minors.
- Securing ticket inventory.
- Illegal gambling machines.
- Unpaid retailer debts.

We found that SCEL has not consistently:

- Established formal policies regarding its practices.
- Promulgated policies and practices in state regulation as required by state law.
- Imposed penalties against retailers, and, when it has imposed penalties, they have sometimes been limited in scope and may be less likely to deter future misconduct.

By not promulgating licensure penalty schedules in regulation for non-cash ticket sales, ticket sales to minors, or ticket inventory security, there may be an increased probability of inconsistency in the suspension and revocation of retailer licenses.

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## State Law Regarding Regulations

S.C. Code §59-150-60(A)(3) authorizes SCEL to promulgate regulations pursuant to the Administrative Procedures Act for the regulation of its affairs and the conduct of its business.

The Administrative Procedures Act (S.C. Code §1-23-10 *et seq.*) defines a regulation as any:

...agency statement of *general public applicability* that implements or prescribes law or policy or practice requirements of any agency. Policy or guidance issued by an agency other than in a regulation does not have the force or effect of law.  
[Emphasis added.]

Furthermore, according to the 1991 S.C. Supreme Court ruling of *Captain's Quarters Motor Inn, Inc. v. South Carolina Coastal Council*, an agency "...overstep[s] its statutory authority in formulating and applying [an agency practice] ...if it does so without formalizing it by regulation."

Since anyone who meets the minimum statutory requirements may apply to SCEL for a license to sell lottery tickets, the agency's licensing criteria and conditions — including those criteria and conditions that may suspend or revoke a retailer's license — have general public applicability.

It is important to note that S.C. Code §59-150-90(B) states that, "[t]he executive director for good cause may suspend, revoke, or refuse to renew a contract entered into as provided by the provisions of this chapter or the regulations, policies, and procedures of the board."

A sanction schedule outlined in regulation could be designed to give SCEL's director flexibility while also providing greater transparency to the offenders and the public regarding the consequences of misconduct.

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## **Inadequate Enforcement of the Prohibition of Non-Cash Sales**

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### **State Law, Regulation, and Agency Contract**

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SCEL has not outlined, in regulation, licensure penalties for retailers who accept non-cash payment for tickets. It also has no mechanism to ensure retailers are not accepting forms of payment other than cash for lottery tickets.

Accepting credit and debit cards can result in higher ticket expenditures by consumers.

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S.C. Code §59-150-70(D)(2) states that “...all sales must be for cash only. Payment by checks, credit cards, charge cards, or other form of deferred payment and payment by debit card are prohibited.”

Additionally, state regulation and the agency’s retailer contract also require that all sales must be cash only. State law, regulation, and the agency’s retailer contract state that violating this provision may result in the suspension or revocation of a retailer’s license, yet none include a penalty structure for initial and subsequent offenses, such as the number of offenses before suspension or revocation occurs.

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### **No Proactive Monitoring of Cash-Only Requirement**

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SCEL does not check whether retailers or their employees comply with the requirement that tickets be purchased with cash only. SCEL’s awareness of and process for addressing this issue is reactive. A proactive approach, such as the use of secret shoppers, would provide a better measure of the extent of this issue among SCEL’s retailers.

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## **Inadequate Enforcement of the Prohibition of Sales to Minors**

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### **State Law, Regulation, and Agency Contract**

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SCEL has not established, in regulation, licensure penalties for retailers and retail employees who sell lottery tickets to minors. It also has no mechanism to ensure retailers and retail employees are not selling tickets to minors.

Studies show that gambling during adolescence is associated with greater gambling involvement in adulthood.

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S.C. Code §59-150-250 states:

A person who knowingly sells a lottery game ticket or share to a person under eighteen years of age or permits a person under eighteen years of age to play a lottery game is guilty of a misdemeanor and, upon conviction, must be fined not less than one hundred dollars nor more than five hundred dollars or be imprisoned not less than thirty days nor more than sixty days, or both, in the discretion of the court.

State law, regulation, and the agency's retailer contract also state that violating this provision may result in suspension or revocation a retailer's license. These penalties, however, are general — applying to sales to minors, non-cash sales of lottery tickets, and failure to secure lottery ticket inventory, among other offenses. There is also no outline of the penalties warranted for initial and subsequent offenses, such as the number of offenses before suspension or revocation occurs.

We found several lotteries that have licensure penalties detailed in sanction schedules, which provide a structured outline of the penalties issued based on the type of offense and the number of times a retailer or his employee committed that offense in a given period. A sanction schedule promulgated in regulation would provide clear guidance for SCEL and its retailers as to what actions can impact their ability to continue selling tickets.

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## Inadequate Enforcement

While SCEL provides retailers with signage stating sales to minors is prohibited and the agency's marketing and sales representatives (MSRs) check that such signage is posted during each sales visit, the agency has not conducted checks to ensure underage sales of lottery tickets is not occurring.

Agency staff have stated that they receive few complaints regarding sales to minors and, therefore, do not believe this to be a problem. Staff also stated that if they found underage sales to be an issue, they would initiate these checks. However:

- It is not clear who would file such complaints, particularly when players appear to be 18 or older but are actually minors.
- SCEL's complaints are not obtained through a random sample of the state's residents and, therefore, cannot be used to determine the extent to which sales of lottery tickets to minors is an issue.

### Checks by Other Lotteries and Agencies

The Ontario lottery, which is part of the same lottery organization as the South Carolina lottery, regularly conducts checks of its retailers for sales to minors through its mystery shopper program. The S.C. Department of Alcohol and Other Drug Abuse Services (DAODAS) oversees underage compliance checks for alcohol and tobacco products.

In our 2010 audit of SCEL, we recommended that SCEL contract with DAODAS to ensure compliance with S.C. Code §59-150-210(D). In 2014 and 2019, we found that the agency had not contracted with DAODAS. SCEL also does not conduct these checks through another organization or internally.

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## Ticket Security Penalties Not in Regulation

While SCEL has a policy regarding the security of tickets by retailers, we found that the agency has not promulgated these penalties in regulation.

The security of ticket inventory is important because it helps to preserve the integrity of lottery tickets. Scratch-off tickets that are reported missing may, in fact, not be missing at all. A retailer may play these tickets without having purchased them, pay for them if s/he finds a winning ticket, and report the losing tickets as missing. This gives retailers an unfair advantage over non-retailer players.

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## State Law, Regulation, and Agency Retailer Contract

S.C. Code §59-150-180 requires retailers to accurately account for tickets. Regulation 44-20.60(D)(3) requires retailers to take adequate security precautions for the safe handling of tickets. SCEL's retailer contract states that retailers agree to provide reasonable security for all tickets.

In addition, state law, regulation, and the retailer contract authorize SCEL to suspend or revoke a retailer's license for violating provisions within the law, regulation, or its contract. These penalties, however, are general and not specifically directed to infractions involving ticket security.

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## SCEL's Policy

In March 2017, SCEL implemented a policy memorandum that penalizes retailers for missing scratch-off tickets, among other infractions.

In the absence of a penalty structure for inadequate ticket security in the agency's regulations, agency policy prescribes such penalties for each offense, which are progressive and accrue cumulatively. Table 4.1 summarizes the agency's penalties for first and subsequent offenses.

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**Table 4.1: Penalties Required by Agency Policy for Retailers Who Fail to Adequately Secure Ticket Inventory**

OFFENSE	PENALTY
1 <sup>st</sup>	Written warning
2 <sup>nd</sup>	Minimum 24-hour terminal deactivation
3 <sup>rd</sup>	Minimum 5-day terminal deactivation with the possible added penalty of suspension or revocation

Source: SCEL Inventory Accountability Memorandum



Table 4.2 summarizes the agency’s penalties since the policy’s implementation in March 2017 through the end of calendar year 2017.

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**Table 4.2: Number of Agency Penalties Imposed on Retailers Since March 2017 Policy Implementation**

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OFFENSE	PENALTY
1 <sup>st</sup>	300
2 <sup>nd</sup>	21
3 <sup>rd</sup>	1

Source: LAC analysis of SCEL’s penalty data.

While the penalties outlined in SCEL’s policy are not inconsistent with state law, regulation, or the agency’s retailer contract, a penalty structure in regulation — including the penalty warranted for initial and subsequent offenses and the number of offenses before suspension or revocation occurs — would increase transparency among the public and facilitate equity in retailer discipline as it relates to this issue.

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## Inconsistent Enforcement of Unpaid Retailer Debts to SCEL

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SCEL’s regulations outline a progressive disciplinary structure for retailers who have not fully paid SCEL for their tickets; the agency refers to an infraction of this type as non-sufficient funds or NSF’s. SCEL’s practice, however, of issuing NSF’s is inconsistent with the penalties and penalty structure as stated in regulation.

SCEL sells tickets to retailers on consignment, meaning after a given period, the agency charges a retailer for the actual amount of tickets s/he sold, less the retailer’s commission. When retailers cannot pay for tickets sold by the contractual deadline, the agency’s NSF practice is initiated.

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## State Law and Regulation

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S.C. Code §59-150-190(A) states, “[a] lottery retailer ... [has] a fiduciary duty to preserve and account for lottery proceeds, and a lottery retailer is personally liable for all proceeds.” S.C. Regulation 44-90.20(B) outlines disciplinary actions for retailers receiving one or more NSF’s, which are detailed in Table 4.3.

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**Table 4.3: Penalties Required in S.C. Regulation 44-90.20(B) for Retailers With Unpaid Debts to SCEL**

OCCURRENCE	PERIOD	PENALTY
1st	12-month	Written warning
2nd	12-month	Up to 7-day suspension of all lottery activity, plus fine
3rd	12-month	Up to 30-day suspension of all lottery activity, plus fine
4th	Any period	License Revocation

Source: S.C. Regulation 44-90.20(B)

This regulation states that SCEL “shall suspend all lottery activity by the [offending] lottery retailer” for a period of time, which increases with each additional offense, for the first three offenses in a 12-month period. It also states that a fourth NSF “in any period” shall then result in revocation of a retailer’s license. SCEL policy, which is authorized in state law, requires a 10-year lapse before the agency will issue a license to a retailer who violated this regulation. This regulation also authorizes broad discretion to the agency’s director in determining whether the provisions of this regulation have been violated.

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## SCEL Practice

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### Penalties Imposed Different and Less Severe Than in Regulation

It is SCEL’s practice not to *suspend* all lottery activity by a retailer but rather *deactivate* the lottery terminal. Suspending all lottery activity would halt a retailer’s authority to sell any and all tickets. A terminal deactivation halts only the sale of draw tickets. A retailer with a 7-day suspension can still sell his or her stock of already-activated scratch-off tickets during that time. The majority of ticket revenues come from scratch-off tickets, which allows retailers, in the short term, to continue selling the most popular games.

### **Penalty Structure Different Than in Regulation**

It is also not SCEL's practice to revoke the licenses of retailers with four NSF's regardless of the period in which they were accumulated. Rather, it is generally agency practice to only issue revocations to retailers that receive a fourth NSF in a 12-month period.

Regarding S.C. Regulation 44.90(B)(4), SCEL officials stated that mandatory license revocation for a fourth violation "in *any* period" was written in error and should instead be for "*any 12-month* period," as stated for the three lesser offenses.

It is important to note, that S.C. Code §1-23-120(J) requires state agencies "...to conduct a formal review of all regulations..." every five years, and S.C. Code §1-23-120(J)(2) requires that:

Upon completion of the review, the agency shall submit to the Code Commissioner a report which identifies those regulations for which the agency intends to begin the process of amendment in accordance with this article.

S.C. Regulation 44-90.20(B)(4) became effective in June 2002. SCEL has not submitted proposed amendments to this section of its regulations to clarify this error.

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## **Penalties for Operating Illegal Gambling Machines Inconsistent with Contract**

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### **State Law, Regulation, and Agency Retailer Contract**

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SCEL, in its retailer contract, established standard penalties for lottery retailers who operate illegal gambling machines. Since at least calendar year 2015, however, the penalties imposed by SCEL have been consistently lower than stated in the contract.

S.C. Code §12-21-2710, which is not specific to lottery retailers, prohibits the operation of video-poker and similar gambling machines.

SCEL’s retailer contract states that the penalty for operating such a device, with no right to appeal, is “a voluntary 6-month (180-day) suspension of lottery sales” at the store from which the device was seized.

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### **SCEL Practice**

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We reviewed SCEL’s suspensions for retailers from calendar years 2015–2017 and found that none of the 8 retailers with gambling machine violations received a 180-day license suspension. Instead, the longest penalty length issued was a 30-day license suspension (see Chapter 6).

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## **Penalties Regarding Retailer Accountability for the Actions of Employees Not in Regulation**

SCEL imposes penalties on retailers for the actions of their employees, but has not promulgated regulations specifying the penalties.

Although state law, regulation, and the retailer contract authorize SCEL's director to suspend or revoke a retailer's license for violating provisions within the law, regulation, or its contract, these penalties are general and do not specifically address misconduct by retail employees.

Some retail employees may sell and redeem tickets as often or more often than the retailer owners. Employee misconduct, therefore, may impact the integrity of SCEL more than retail owner misconduct.

SCEL officials stated that, when determining licensure sanctions in response to employee misconduct, it is the agency's practice that, "[a]mong other factors, [it] takes into consideration the type of misconduct, the employee's position within the business, the licensee's knowledge of or involvement in the misconduct, and the supporting evidence of the misconduct." Although valid, these factors have not been promulgated in regulation, as required by law (see *State Law Regarding Regulations*). As a result, it may not be clear to retailers and the public whether and how SCEL intends to penalize retailers for the misconduct of its employees. A penalty structure — including the penalties warranted for initial and subsequent offenses and the number of offenses before suspension or revocation occurs — would increase transparency and ensure equity in retailer discipline as it relates to this issue.

Other lotteries have sanction schedules that include the penalties against a retailer's license when retail employees commit the violation. These are usually lesser penalties than if the retailer committed the violation.

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## Recommendations

21. The South Carolina Education Lottery should establish specific penalty structures or schedules in regulation for lottery retailers and their employees who:
  - Accept non-cash forms of payment for lottery tickets.
  - Sell lottery tickets to minors.
  - Fail to properly secure ticket lottery inventory.
22. The South Carolina Education Lottery should periodically conduct secret checks or secret shopping reviews of its retailers to determine if they are accepting non-cash payment for lottery tickets.
23. The South Carolina Education Lottery should periodically conduct secret checks or secret shopping reviews of its lottery retailer network or contract with another entity, such as the S.C. Department of Alcohol and Other Drug Abuse Services, to determine if retailers are selling tickets to minors.
24. The South Carolina Education Lottery should suspend any and all lottery activity of retailers with unpaid debts, as outlined in state regulation.
25. The South Carolina Education Lottery should penalize retailers on the fourth instance of unpaid debts owed to the lottery, in the manner written in state regulation.
26. The South Carolina Education Lottery should adhere to the penalty length prescribed in the retailer contract for retailers that operate illegal gambling machines.
27. The South Carolina Education Lottery should establish in regulation the penalties that will be issued against a retailer's license for the misconduct of the retailer's employees.

# Operating a State Lottery Versus Alternative Sources of Revenue

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Section 2-15-50(b)(2) of the S.C. Code of Laws requires the Legislative Audit Council to indicate in its audit reports whether “organizations, programs, activities, or functions should be continued, revised, or eliminated....”

The lottery has generated significant revenue for education in South Carolina but requires additional administrative expenses and may rely disproportionately on lower-income residents for its customers.

In this section, we address the various pros and cons of using a lottery to raise revenue. However, due to the subjective nature of weighing these factors, we are not offering a recommendation on whether the lottery in South Carolina should be continued. Throughout this report, we make recommendations on revising SCEL operations.

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## Generating Revenue by Creating a New State Government Enterprise

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Generating revenues through a lottery instead of increasing or expanding a pre-existing tax (such as the state income tax or state sales tax) required the creation of a new state government enterprise.

As shown in Table 5.1, in FY 17-18 SCEL reported a net income of \$437.9 million, of which \$431 million was transferred to the Education Lottery Account (ELA).

To generate that income, SCEL sold over \$1.7 billion in lottery tickets and incurred \$1.3 billion in expenses, including \$1.1 billion for prize payments and \$166 million for various administrative costs.

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**Table 5.1: SCEL Revenues and Expenses (in millions), FY 17-18**

REVENUES	
Scratch-Off Games	\$1,260.6
Draw Games	489.6
Other Revenues	3.7
<b>TOTAL REVENUES</b>	<b>\$1,753.9</b>
EXPENSES	
Scratch-Off Game Prize Payments	\$911.3
Draw Game Prize Payments	238.5
Retailer Commissions and Incentives	123.5
Other Game-Related Costs	18.7
Operating Expenses	24.0
<b>TOTAL EXPENSES (EXCLUDING TRANSFERS TO THE ELA)</b>	<b>\$1,316.0</b>
<b>NET INCOME</b>	<b>\$437.9</b>
<b>TRANSFERS TO THE ELA</b>	<b>\$431.0</b>

Source: S.C. Education Lottery Annual Report

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## Allocation of Lottery Proceeds to Education by the General Assembly

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Lottery revenues allocated by the General Assembly to education in South Carolina have been accompanied by a decrease in the percentage of non-lottery funds allocated to education.

In 2018, we reported that, since the lottery's inception, approximately \$5 billion in lottery proceeds had been allocated by the General Assembly from the Education Lottery Account to education and related programs. Contrary to state law, there was also a decrease in the percentage of non-lottery, recurring state revenues allocated to education during the same period, resulting in a cumulative deficit of approximately \$2.1 billion from the inception of the lottery through FY 17-18.

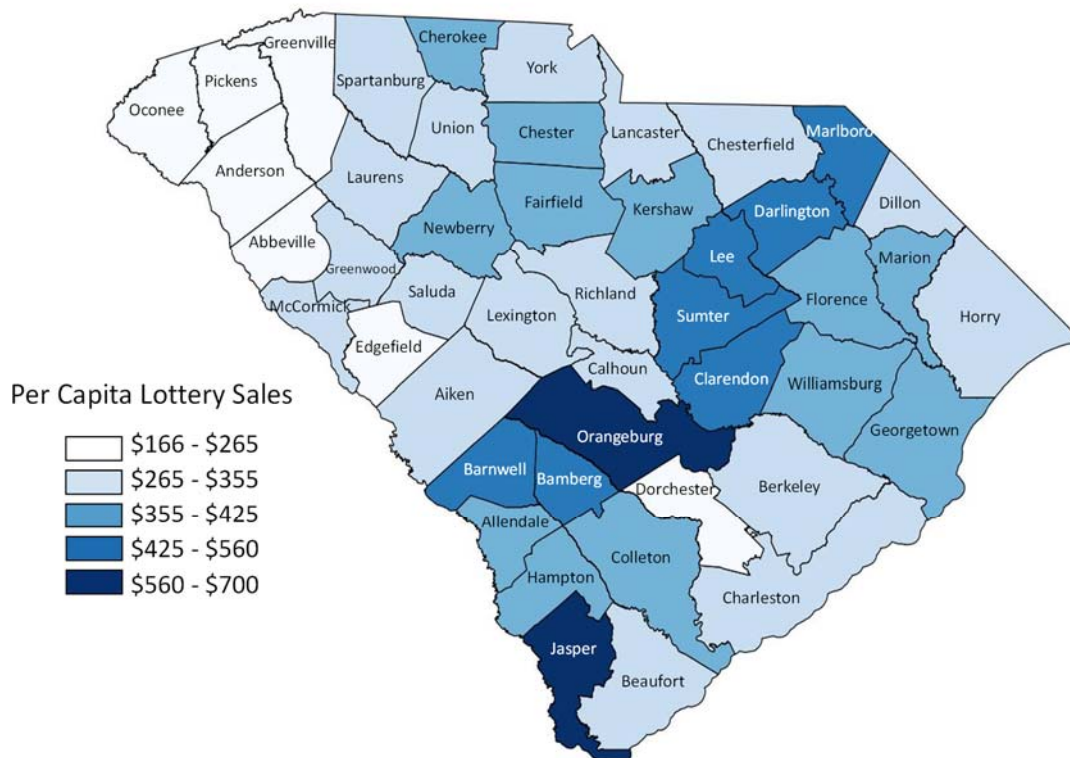
A detailed description of the data cited above is in our June 2018 report, *South Carolina's Use of Education Lottery Account Funds*.



## Lottery Tickets Purchased in Lower-Income Counties

Figure 5.2 and Table 5.3 show that per capita lottery sales in FY 16-17 varied significantly between counties, with greater per capita numbers in lower-income counties.

**Figure 5.2: Lottery Sales by County Per Capita, FY 16-17**



Note: County population statistics drawn from the 2016 American Community Survey 5-Year estimates.

Source: S.C. Education Lottery, U.S. Census

Table 5.3 presents data from the five counties with the highest lottery sales per capita — Orangeburg, Jasper, Clarendon, Bamberg, and Sumter. Median lottery sales per capita were 56% higher than the statewide median, while the median income per capita was 10% lower.

Table 5.3 also presents data from the five counties with the lowest lottery sales per capita — Oconee, Pickens, Greenville, Abbeville, and Dorchester. Median lottery sales per capita were 41% higher lower than the statewide median, while the median income per capita was 21% higher.

**Table 5.3: Counties with the Highest and Lowest Lottery Sales Per Capita, FY 16-17**

COUNTIES	MEDIAN LOTTERY SALES PER CAPITA *	MEDIAN INCOME PER CAPITA **
<b>FIVE COUNTIES WITH THE HIGHEST LOTTERY SALES PER CAPITA</b>	<b>\$581</b>	<b>\$20,067</b>
Orangeburg Jasper Clarendon Bamberg Sumter	56% <i>above the</i> statewide median	10% <i>below the</i> statewide median
<b>FIVE COUNTIES WITH THE LOWEST LOTTERY SALES PER CAPITA</b>	<b>\$221</b>	<b>\$26,798</b>
Dorchester Abbeville Greenville Pickens Oconee	41% <i>below the</i> statewide median	21% <i>above the</i> statewide median
<b>ALL COUNTIES</b>	<b>\$374</b>	<b>\$22,187</b>

\* FY 16-17 sales and 2016 population.

\*\* 2013–2017 median income per capita in 2017 dollars.

Source: S.C. Education Lottery, U.S. Census

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## **SCEL Survey of Lottery Player Demographics**

Section §59-150-325(C) of the S.C. Code of Laws requires SCEL to conduct a demographic analysis of lottery players every year for the first five years of its existence. Since 2008, SCEL has conducted demographic surveys every other year, including most recently in 2016.

The 2016 survey had several characteristics that prevent extrapolating its results statewide or to subgroups.

- The survey was not conducted through formal random sampling.
- The survey results were not weighted to ensure proportional representation of demographic groups, as was done in previous years' surveys. Underrepresented categories of players include men, African Americans, and persons with a high school diploma or less.
- Survey respondents coded as "Current Players" spent an average of \$20.50 per month on lottery games. However, this figure is heavily skewed by a small number of big spenders. The most common response — given by almost 25% of Current Players surveyed — was \$0 per month.

The 2016 survey found that non-white respondents spent more on average per month on lottery games than white respondents, and those with household incomes less than \$50,000 per year spent more on average per month on the lottery than those who made more than \$50,000 per year.

A previous survey found that African American and Hispanic lottery players spent more on average per month than white players. It also found that players with household incomes of less than \$35,000 or incomes of \$150,000 or more spent more per month than those with incomes in between. Additionally, players with a high school education or less spent more on average than those with higher education.

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## **Option of Increasing or Expanding a Pre-Existing State Tax in Lieu of a Lottery**

There are sources of potential revenue in addition to a state lottery.

In FY 17-18, the South Carolina Department of Revenue (SCDOR) collected \$4.4 billion in individual income tax revenues. The state also collected \$4.7 billion in retail sales and use tax revenues.

If, instead of establishing a lottery, the state had reduced exemptions or increased the rates of these or other state taxes, the same \$437.9 million in lottery revenues could have been collected without the overhead required by the establishment of a lottery. SCDOR reported administrative costs of 0.65% as a percentage of the taxes it collected in FY 16-17.

For example, a 9.9% increase in individual income tax rates in FY 17-18 would have generated approximately the same revenue as the lottery. Under this scenario, the top marginal rate would have been increased to 7.7% from the prior rate of 7%.

Another example of an alternative to the lottery would be reducing state sales and use tax exemptions, which are projected to be \$3.4 billion in FY 19-20 by the S.C. Board of Economic Advisors.

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## **Cross-Border Purchases in the Absence of a South Carolina Lottery**

If South Carolina were to discontinue its lottery, a portion of its residents would likely purchase tickets in our neighboring states of Georgia and North Carolina.

The extent of cross-border purchases that would be made by South Carolinians in the absence of a South Carolina lottery is unclear. The last time South Carolina did not have a lottery was in 2001. At that time, North Carolina did not have a lottery.

# Other Issues and Status of Prior LAC Recommendations

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In this chapter, we note:

- The absence of a specific statute addressing the anonymity of prize claimants.
- Illegal political contributions made by SCEL commissioners.
- The implementation status of prior LAC recommendations.

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## No Specific Statute Regarding the Anonymity of Prize Claimants

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In the absence of a specific statute, South Carolina's lottery has used its discretion in recent years to keep anonymous the identity of all prize claimants. A specific state statute would ensure that South Carolina's policy has been formally considered and debated by lawmakers.

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### State Law

Whether to release winners' identities is an effort to strike a balance between openness in the operation of government versus protection of claimants from being preyed upon financially and physically.

In 2015, the Court of Common Pleas in Richland County, South Carolina, ruled that SCEL's policy of withholding the personal identity of prize claimants was authorized under state law, although the law is not specific to the lottery. The court ruled that SCEL may but is not required to withhold the identity of prize claimants.

S.C. Code §30-4-40(a) of the S.C. Freedom of Information Act states:

A public body *may but is not required* to exempt from disclosure... [i]nformation of a personal nature where the public disclosure thereof would constitute unreasonable invasion of personal privacy. Information of a personal nature shall include, but not be limited to, information as to gross receipts contained in applications for business licenses, information relating to public records which include the name, address, and telephone number or other such information of an individual.... [Emphasis added.]

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## Use of Prize Claimant Identities for Advertising

SCEL's claim form — which is required for prizes greater than \$500 — informs claimants that their names and other information may be subject to disclosure under the S.C. Freedom of Information Act. It also requires claimants to indicate whether they give SCEL permission to use photographs, video recordings, or audio recordings with their images or voices "... for purposes of advertising or trade of SCEL."

SCEL has sometimes released to the public photographs of claimants holding oversized checks, which indicate the prize amounts won and, in certain instances, the claimants' first and last names.

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## Arguments in Favor of Public Disclosure

- The general public can observe that lottery prizes are being awarded.
- The general public can observe whether persons not eligible to play, such as lottery employees, have won prizes.
- The general public can identify frequent prize-claiming patterns over time that would be highly improbable if the tickets were legally purchased at face value from licensed retailers.
- Creditors can identify players with newly acquired assets.

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## Arguments Against Public Disclosure

- Claimants experience reduced privacy.
- Claimants may become victims of financial predators.
- Claimants may become victims of violent crime. In the worst of cases, lottery winners have been killed.

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## Other Approaches to the Issue of Public Disclosure

In addition to anonymity for all prize claimants, there are other approaches to the issue of public disclosure, such as:

*Requiring public disclosure except for claimants who can demonstrate potential harm.*

In North Carolina, the identities of claimants maintained by the lottery are public record unless a claimant presents a valid protective court order or is part of the state's Address Confidentiality Program, which helps victims keep abusers from discovering their addresses.

*Requiring public disclosure only of claimants who win smaller amounts.*

Georgia allows anonymity, upon request, for winners of \$250,000 and more.

*Requiring public disclosure after a mandated cooling off period that follows the winning of a prize.*

Such a period — which could last for an extended period of time — would address the need for transparency and integrity while the passage of time could allow the claimant to take measures to reduce the risk to personal safety and the risk to financial security.

In Arizona, the identities of claimants maintained by the Lottery are kept confidential for 90 days after a prize has been awarded and then become public. Anonymity is continued, upon request, for individuals who have received lottery prizes of \$100,000 or more.

*Allowing a lottery prize claimant the right to assign the prize to a trust or business corporation that can keep the identity of a winner of a lottery ticket confidential.*

In South Carolina, Regulation 44-70 requires that a claim be made in the name of a "single natural person," which may exclude the option of a trust or business corporation.

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## Recommendations

28. The General Assembly should amend state law to specify whether public disclosure of the identity of lottery prize claimants is required.
29. If state law is amended to require public disclosure of lottery prize claimants, the General Assembly should also amend state law to specify:
  - The circumstances under which public disclosure of lottery prize claimants is required.
  - Whether a cooling off period prior to disclosure is required.
  - The specific information about lottery prize claimants that must be disclosed.

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## Political Contributions by SCEL Commissioners

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We found that, according to publicly reported information, three members of the SCEL board of commissioners made political contributions during their tenure, including contributions to candidates for the General Assembly, in violation of state law.

According to S.C. Code §59-150-40(L), members of the SCEL board of commissioners:

...shall not contribute to or make independent expenditures relative to the campaign of a candidate for the General Assembly or a statewide constitutional office; to a political party, as defined in Section 8-13-1300(26); or to a committee, as defined in Section 8-13-1300(6). *A member of the board who violates this section must be summarily dismissed.*  
[Emphasis added.]

Additionally, S.C. Code §59-150-40(M) states that “[a] member is appointed to the board for a term and may be removed from the board before the expiration of his term only as provided in Section 1-3-240(C).” S.C. Code §1-3-240(C) states that the Governor may remove members of the South Carolina Lottery Commission for “malfeasance, misfeasance, incompetency, absenteeism, conflicts of interest, misconduct, persistent neglect of duty in office, or incapacity.”



Political contributions made by the three members of the S.C. Lottery Commission during their time in office were as follows:

- \$100 to a state banking Political Action Committee.
- \$1,488 to a state and local Political Action Committee associated with a law firm.
- \$950 to candidates for the General Assembly.

After informing SCEL of these findings, two Commissioners were reimbursed for their donations detailed above and the third Commissioner resigned.

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## Recommendation

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30. To ensure compliance with S.C. Code §59-150-40(L), the South Carolina Education Lottery should periodically check public records regarding political contributions made by its commissioners.
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## Status of Prior LAC Recommendations

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We reviewed all eight of the recommendations from our 2003, 2005, and 2010 SCEL audits that we previously found were not fully implemented. We also reviewed the two recommendations from our 2014 audit.

2014

*A Review of the South Carolina Education Lottery*

2010

*An Audit of the South Carolina Education Lottery*

2005

*A Review and Follow-Up Report of the South Carolina Education Lottery*

2003

*A Review of the SC Education Lottery and the State's Use of Lottery Proceeds*

As of FY 17-18, one of these recommendations was implemented, two recommendations were partially implemented, five recommendations were not implemented, and two recommendations were no longer applicable.

STATUS OF RECOMMENDATIONS	NUMBER
Implemented	1
Partially Implemented	2
Not Implemented	5
Not Applicable	2
<b>TOTAL</b>	<b>10</b>

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**OCTOBER 2014**

**Recommendation 1**

**The South Carolina Education Lottery should submit a proposed regulation to the General Assembly to amend S.C. Regulation 44-40.10(C)(2) to state that once a retailer has been notified that the last top prize of an instant [scratch-off] game has been claimed, sales of those game tickets must be discontinued immediately.**

**NOT IMPLEMENTED**

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In 2014, we reported that SCEL had not submitted a proposed regulation to the General Assembly to reflect the change in the agency's end-of-game policy to end sales after the last top prize of a scratch-off game has been claimed.

In our current follow-up review, we found that SCEL had not submitted a proposal to amend S.C. Reg. 44-40.10(C)(2). The South Carolina State Register, which is published monthly, cites the official compilation of state agency regulations. This regulation has not been amended. The regulation still reads, "A lottery retailer may continue to sell tickets for each instant [scratch-off] game up to ninety (90) days after the official end of that game."

We made a similar recommendation in December 2005.

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**OCTOBER 2014**

**Recommendation 2**

**The South Carolina Education Lottery and the Board of Economic Advisors (BEA) should consider the results of additional methods when estimating unclaimed prizes for use by the General Assembly during the appropriations process.**

**IMPLEMENTED**

In 2014, we reported that SCEL could use additional methods to better estimate the amount of unclaimed prizes. We also reported that, between FY 11-12 to FY 13-14, SCEL revised its estimates of unclaimed prize revenue throughout the fiscal year, which resulted in more accurate results. For FY 13-14, for example, SCEL projected that unclaimed prize revenues would be \$8 million, even though revenues in the preceding year had been \$12.4 million. Actual revenues for FY 13-14 were \$14.3 million.

In our current follow-up review, we found that, in FY 15-16, SCEL adopted a new methodology that uses an average based on the ratio of unclaimed prizes to revenues for each game and product type. SCEL and BEA maintain regular contact to discuss revenue estimates for unclaimed prizes.

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**FEBRUARY 2010**

**Recommendation 4**

**The South Carolina Education Lottery should contract with the Department of Alcohol and Other Drug Abuse Services [DAODAS] to conduct periodic checks of retailers' compliance with S.C. Code §59-150-210(D).**

**NOT APPLICABLE**

In 2010, we reported that SCEL had implemented several initiatives to deter the sale of tickets by retailers to minors, which is prohibited by S.C. Code §59-150-210(D). We also reported that SCEL had not conducted compliance checks of retailers on a regular basis to determine the extent to which they would sell tickets to minors.

In our 2014 and current follow-up reviews, we found that SCEL had not contracted with DAODAS to conduct retailer checks. At the same time, we determined that it may be feasible for other entities, in addition to DAODAS, to conduct these checks. In Chapter 4, we address sales to minors in greater detail, adding a new recommendation that replaces the 2010 recommendation.

It is important to note that in our June 2018 report, *South Carolina's Use of Education Lottery Account Funds*, we recommended that the General Assembly amend state law to require SCEL to allocate a specific annual amount of its operating expenses to DAODAS, or appropriate a specific amount annually from the General Fund to DAODAS, for gambling addiction programs. As a result, Recommendation 4 in the 2010 audit is no longer applicable.

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**DECEMBER 2005**

**Recommendation 7**

**When the South Carolina Education Lottery advertises a top prize for any of its games on television or radio, it should verbally communicate in the ad the odds of winning a top prize.**

**PARTIALLY IMPLEMENTED**

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In 2005, we reported that SCEL did not communicate the odds of winning a top prize in any of its television and radio advertisements. In 2010 and 2014, we reported that not all SCEL advertisements verbally communicated the odds of winning a top prize.

In our current follow-up review, we analyzed six lottery advertisements. These comprised television and radio Responsible Play advertisements that aired as well as two television and two radio advertisements, all of which aired in July 2017. We found that none of the television advertisements *verbally* communicated the odds or probability of winning a top prize. Only one of the three radio advertisements communicated the odds or probability of winning a top prize.

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**DECEMBER 2005**

**Recommendation 9**

**The SCEL should obtain and follow advice from reading/literacy experts to ensure that written communications to lottery customers can be read by persons with moderate reading skills.**

**PARTIALLY IMPLEMENTED**

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In 2005, we reported that SCEL had not consulted with reading or literacy experts to increase the likelihood that its communications could be understood by customers with moderate reading skills.

In 2010, we reported that SCEL had consulted with literacy experts regarding marketing material used at its retail play stations, but not regarding the language printed on its tickets.

In 2014, we reported that SCEL had not taken further action to implement this recommendation.

During our current follow-up review, SCEL provided readability reports generated by *Readable.io*, a website that scores the readability and grade level of text, for a *Clean Sweep* game brochure and changes made to the text on the back of a scratch-off ticket. While *Readable.io* may be a useful website in scoring the readability and grade level of text, it may not be sufficient to ensure that written communications to lottery customers can be read by persons with moderate reading skills.

We consulted with an official from the Columbia-based literacy council, *Turning Pages Into Possibilities*, which helps adults improve their reading and English language skills. The official reviewed a sample of written materials produced by SCEL as of December 2017, including five brochures and five scratch-off tickets, to determine whether they can be read by persons with moderate reading skills. Comments from this official included the following:

- The print on the smaller scratch-off tickets is too small.
- More graphics and pictures, and less writing, on printed materials could aid adults who are functionally illiterate or have limited English proficiency.
- Printing the odds of **not** winning on the scratch-off tickets may confuse players. For example, one ticket stated that the odds of winning were 1 in 4.51, while the odds of **not** winning were 1 in 1.28.

Lotteries in North Carolina and Georgia include neither the odds nor probability of **not** winning on their scratch-off tickets.

S.C. Code §59-150-60(A)(18) states the following regarding retailer signage, which does not address tickets:

Wherever lottery game tickets are sold, a lottery retailer must post a conspicuous sign in a prominent location, inside the retailer's premises and adjacent to the point of sale, clearly warning of the dangers and risks of gambling and the odds of winning and the odds of losing...

Whether on a lottery ticket or on display at the point of sale, communicating the odds or probability of **not** winning may confuse players.

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**DECEMBER 2005**

**Recommendation 12**

**The SCEL should submit a request to the General Assembly to amend S.C. Regulation 44-40.10(C)(2), so that lottery retailers are required to discontinue the sale of scratch-off lottery tickets immediately after being notified that a game has been officially ended.**

**NOT IMPLEMENTED**

In 2005, we found that S.C. Regulation 44-40-10(C)(2) stated, “A lottery retailer may continue to sell tickets for each instant (scratch-off) game up to ninety (90) days after the official end of that game.”

In our 2010, 2014, and current follow-up reviews, we found that SCEL had not submitted a request to the General Assembly to amend S.C. Regulation 44-40.10(C)(2). SCEL policy, effective 2017, requires that the sale of tickets be discontinued after a game has officially ended.

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**DECEMBER 2005**

**Recommendation 13**

**The General Assembly should approve a request from the South Carolina Education Lottery to amend S.C. Regulation 44-40.10(C)(2), so that lottery retailers are required to discontinue the sale of scratch-off lottery tickets immediately after being notified that a game has been officially ended.**

**NOT APPLICABLE**

In 2005, we reported that, in 2002, the General Assembly approved S.C. Regulation 44-40.10(C)(2), which stated, “A lottery retailer may continue to sell tickets for each scratch-off game up to ninety (90) days after the official end of that game.”

In our 2010, 2014, and current follow-up reviews, we found that SCEL had not submitted a request to the General Assembly to amend S.C. Regulation 44-40.10(C)(2).

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**DECEMBER 2005**

**Recommendation 18**

**The General Assembly should amend state law to authorize the SCEL to deny, suspend, revoke, or terminate the contracts of lottery retailers or applicants who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction.**

**Recommendation 19**

**The General Assembly should amend state law to authorize the SCEL to impose administrative fines against lottery retailers who have been found to have allowed illegal gambling on their premises, regardless of whether it is an administrative violation or a criminal conviction.**

**NOT IMPLEMENTED**

In 2005, we reported that SCEL had not specifically prohibited illegal gambling in its retail contracts. We found that, if the lottery were to specify illegal gambling in its retail contract as a reason to suspend, revoke, or terminate a contract, or to impose a fine, it could initiate such actions by claiming a contract violation, with or without a criminal conviction.

However, in 2005, lottery officials stated that it “is likely to be beyond SCEL’s statutory authority” to penalize a retailer for illegal gambling, in the absence of a criminal conviction, even if specified in the contract. State law also did not give the lottery authority to issue administrative fines against its retailers for illegal gambling. State law required that a retailer contract executed by the [lottery] commission pursuant to this chapter must specify the reasons for which the contract may be canceled, suspended, revoked, or terminated by the commission.

In our 2010 and 2014 follow-up reviews, we found that state law had not been amended to authorize SCEL to deny, suspend, revoke, or terminate retailers, or to impose a fine against lottery retailers who allow illegal gambling on their premises.

In our current follow-up review, we found that state law regarding retailer penalties for illegal gambling had not yet been amended. Nonetheless, SCEL’s contract with its retailers now states that a criminal conviction for operating an illegal gambling machine may be accompanied by a license suspension or revocation by SCEL. The contract does not address fines nor does it address administrative violations.

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**DECEMBER 2003**

**Recommendation 6**

**The South Carolina Education Lottery should develop performance measures for all departments and include these measures in its annual report.**

**NOT IMPLEMENTED**

In 2003, we reported that SCEL did not have formal measures of outcome and performance except for revenues received from the sale of tickets. We noted that Florida and Texas lotteries had formal outcome and output performance standards in place.

In 2005, we reported that SCEL officials had developed performance measures, such as the number of reports of retailer misconduct received and resolved, and included them in SCEL’s annual report.

In our current review, we found that SCEL had published two reports with measures of performance and success in FY 04-05 and FY 07-08. Those reports cited data on reports and investigations of retailer misconduct. Since FY 07-08, SCEL has not published annual data pertaining to retailer misconduct (see *Publicizing the Results of the Compliance Checks*).

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## **Recommendations in 2019**

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31. The South Carolina Education Lottery should discontinue the practice of including the odds of *not* winning on its lottery tickets.
  32. The General Assembly should amend S.C. Code §59-150-60(A)(18) to no longer require that the odds of *not* winning lottery games be displayed at retailer points of sale.



# Recommendations

Rec. #	THE S.C. GENERAL ASSEMBLY SHOULD: (11 TOTAL)	Page
<b>Chapter 2</b>		
1.	Consider amending state law to direct an entity independent of lottery sales — such as the S.C. Department of Revenue, another existing state agency, or a newly-created state agency — to be responsible for issuing lottery licenses and overseeing compliance with state laws and regulations by retailers and players.	15
2.	If the General Assembly does not implement recommendation 1, it should implement the recommendations in this report that suggest state law be amended to require the South Carolina Education Lottery to more aggressively oversee retailer and player integrity.	15
<b>Chapter 3</b>		
3.	Obtain a formal opinion from the Office of the Attorney General on the legality of purchasing and selling winning lottery tickets in resale transactions.	24
4.	If the Office of the Attorney General determines that lottery ticket resale transactions are legal under current state law, the General Assembly should amend state law to explicitly prohibit the practice.	24
5.	Amend state law to require the withholding of lottery prize winnings greater than \$500 to settle debts of any amount owed by prize winners where the state is either the creditor or a collection agent for creditors.	25
12.	Amend state law to authorize the South Carolina Education Lottery to collect information identifying lottery retail employees in order to maintain a database of individuals who have greater incentive to engage in misconduct with lottery tickets.	37
16.	Amend state law to ban lottery retailers, retail employees, and household family members of retailers from purchasing tickets from the retail stores at which they or their relatives work.	52
19.	Amend state law to require the suspension of prize claiming privileges of individuals with frequent and highly improbable prize claiming patterns.	52

Rec. #	THE S.C. GENERAL ASSEMBLY SHOULD: (11 TOTAL)	Page
Chapter 6		
28.	Amend state law to specify whether public disclosure of the identity of lottery prize claimants is required.	74
29.	If state law is amended to require public disclosure of lottery prize claimants, the General Assembly should also amend state law to specify: <ul style="list-style-type: none"><li>• The circumstances under which public disclosure of lottery prize claimants is required.</li><li>• Whether a cooling off period prior to disclosure is required.</li><li>• The specific information about lottery prize claimants that must be disclosed.</li></ul>	74
32.	Amend S.C. Code §59-150-60(A)(18) to no longer require that the odds of <i>not</i> winning lottery games be displayed at retailer points of sale.	82

Rec. #	THE SOUTH CAROLINA EDUCATION LOTTERY SHOULD: (21 TOTAL)	Page
Chapter 3		
6.	Amend its retailer contract regarding the prohibition against purchasing winning lottery tickets for less than the prize amounts by defining the parties to whom it applies.	33
7.	Develop a formal policy regarding the measures it uses to enforce its prohibition against retailers purchasing winning lottery tickets for less than the prize amounts.	33
8.	Require lottery retailers, employees, and retailers' household family members to identify as such on the claim form when redeeming a winning lottery ticket.	33
9.	Prior to paying claims, automatically check to determine whether the prize claimants are active lottery retailers or associated with lottery retailers.	33
10.	Conduct its undercover checks of retailers' compliance with state law and contract using a continual schedule that minimizes the chance the retailers will know when a check is more likely to occur.	33
11.	Conduct more robust retailer undercover compliance checks for the purchase of winning tickets by implementing the following: <ul style="list-style-type: none"> <li>• Use of undercover agents who reflect the demographics of the retailers' customers.</li> <li>• Use of undercover agents from populations that are more vulnerable to retailer misconduct.</li> <li>• Varying the process from store to store.</li> <li>• Use of a suggestive approach.</li> <li>• Publicizing disciplinary actions on its website.</li> </ul>	33
13.	Develop and renew annually a database that includes all employees of lottery retailers.	37
14.	Routinely conduct statistical probability analysis of the prize claiming patterns of players who frequently redeem winning tickets with larger prizes to determine whether it would be probable for any person to win as frequently. It should use the results of this analysis as a basis for and a component of further investigation.	44
15.	Routinely conduct statistical probability analysis of pairs or groups of claimants who are affiliated and who frequently redeem winning tickets with larger prizes to determine how probable it would be for any pair or group to win as frequently.	52
18.	If the General Assembly does not amend state law to ban lottery retailers, retail employees, and household family members of retailers from purchasing tickets from the retail stores at which they or their relatives work, the South Carolina Education Lottery should establish such a ban.	52
19.	Establish enforcement measures to ensure that retailers, retail employees, and household family members of retailers comply with a ban on purchasing, validating, and redeeming tickets from the retail stores at which they or their relatives work.	52
20.	If the General Assembly implements recommendation 20, the South Carolina Education Lottery should promulgate regulations with: <ul style="list-style-type: none"> <li>• Standards for determining highly improbable prize claiming patterns.</li> <li>• A specified penalty structure.</li> </ul>	52

Rec. #	THE SOUTH CAROLINA EDUCATION LOTTERY SHOULD: (21 TOTAL)	Page
<b>Chapter 4</b>		
21.	Establish specific penalty structures or schedules in regulation for lottery retailers and their employees who: <ul style="list-style-type: none"> <li>• Accept non-cash forms of payment for lottery tickets.</li> <li>• Sell lottery tickets to minors.</li> <li>• Fail to properly secure ticket lottery inventory.</li> </ul>	64
22.	Periodically conduct secret checks or secret shopping reviews of its retailers to determine if they are accepting non-cash payment for lottery tickets.	64
23.	Periodically conduct secret checks or secret shopping reviews of its lottery retailer network or contract with another entity, such as the S.C. Department of Alcohol and Other Drug Abuse Services, to determine if retailers are selling tickets to minors.	64
24.	Suspend any and all lottery activity of retailers with unpaid debts, as outlined in state regulation.	64
25.	Penalize retailers on the fourth instance of unpaid debts owed to the lottery, in the manner written in state regulation.	64
26.	Adhere to the penalty length prescribed in the retailer contract for retailers that operate illegal gambling machines.	64
27.	Establish in regulation the penalties that will be issued against a retailer's license for the misconduct of the retailer's employees.	64
<b>Chapter 6</b>		
30.	Periodically check public records regarding political contributions made by its commissioners to ensure compliance with S.C. Code §59-150-40(L).	75
31.	Discontinue the practice of including the odds of <i>not</i> winning on its lottery tickets.	82

# Methodology of the LAC Analysis of Frequent Prize Claimants

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We analyzed the probabilities associated with individuals who have made frequent prize claims for SCEL games over a nine-year period, from November 2008 through November 2017.

There were 18 individuals who claimed 50 or more lottery prizes each worth more than \$500.

For each of these 18 frequent claimants, we calculated the minimum amount that every resident of South Carolina would have to spend on lottery tickets for there to be a 1-in-10 million chance that any of them would win as frequently as the claimant in question.

We conducted this analysis with the assistance of Professor Philip Stark, University of California, Berkeley, who has provided assistance to individuals analyzing frequent lottery claimants in several other states. Professor Stark referred us to computer code that performs a mathematical analysis he helped develop, which was run in a program called Jupyter®. This code, which can be found at <https://github.com/pbstark/Lotto>, required us to input a file listing lottery prize claims and their respective costs and probabilities of winning. Both draw game and instant tickets were included in our analysis, and only tickets with prizes worth more than \$500 claimed during our chosen time frame were analyzed.

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## Information Regarding Lottery Games

Information regarding the prices, prizes, and probabilities of winning for lottery games were retrieved from the SCEL website. To access information no longer available on SCEL's website, we utilized the Wayback Machine — a digital archive website (<https://archive.org/web>). This was necessary for games that are no longer for sale, as well as for certain draw games (i.e. Powerball and Mega Millions) that changed their prize and/or probability structure during our time frame of interest.

The prices, prizes, and probabilities of winning for the Pick 3, Pick 4, and Palmetto Cash 5 games have all stayed constant over our nine-year time frame.

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## South Carolina Population

In order to conduct our analysis, we needed to provide the size of a lottery-playing population, which we chose to be the population of South Carolina. According to the U.S. Census Population Estimates Program, South Carolina had a total population of 5,024,369 as of July 1, 2017.

This was the most conservative figure we could have used for two reasons. First, the population of South Carolina increased over our nine-year time frame, and, because larger populations result in lower “minimum spend amounts,” this was the most conservative choice. A second conservative aspect of using this figure is that it includes residents who are too young to legally purchase tickets and residents who choose not to purchase tickets.

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## Conservative Assumptions Due to Limited Available Data for Draw Games

In conducting our analysis, we needed to determine — for each ticket redeemed by the frequent claimants we identified — the cost of that ticket and the probability of winning the prize that was claimed. We also needed to ensure that each ticket redeemed was independent of the others, meaning that winning draw game tickets had to be from different draws (all instant and Add-a-Play tickets were treated as independent). However, we encountered limitations on the availability of detailed data for individual draw game tickets.

To account for these limitations, we made conservative assumptions that resulted in conservative calculations of the minimum spend amount. As a result, the number of winning tickets in our analysis was less than the total number of winning tickets redeemed. These assumptions are addressed below.

### **One Claimant per Ticket**

Although lottery prizes can be divided between multiple people, we determined that every ticket redeemed by the frequent claimants we identified had only a single claimant.

### **Multiple Plays on the Same Ticket**

We assumed that the prize claimed for each winning draw game ticket was from a single draw and a single play wherever possible. For example, a Pick 4 ticket that won \$5,000 could have had two \$2,500 winning plays or one \$5,000 winning play. In circumstances where the prize amount matched to a single prize amount for that game, it was assumed to be a single play.

An exception to this was the Add-a-Play game. Although it is technically a draw game, Add-a-Play tickets function like instant tickets — there can be up to 5 “plays” on a single ticket, but these plays are randomly generated by the lottery terminal at the time of purchase and thus independent of each other. The probability of winning two or more prizes is the probability of winning each individual prize multiplied together, which we did to find the overall probability of winning all the prizes on claimed Add-a-Play tickets. In cases where the precise combination of winning plays could not be determined (for example, a \$510 win could be a \$500 win and a \$10 win, or it could be a \$500 win and two \$5 wins), the probabilities of all possible combinations were added together and the lowest possible price of any of these combinations was used.

Another exception involves “exchange tickets” for draw games. When an individual claims a prize on a winning ticket that has plays remaining for future draws, they are given an “exchange ticket” to function as their ticket if their plays win in any of those future draws. However, because our data does not distinguish between regular and exchange tickets, and because wins on exchange tickets are independent of earlier draws, exchange tickets are included in our analysis without any additional assumptions or considerations.

### **Determining Prize Combinations for Multiple Plays on One Winning Ticket**

The prizes awarded by SCEL for some winning tickets did not align with any single prize amount listed for the relevant game, or they exceeded the top prize amount.

When we encountered this circumstance:

- First, we determined what combinations of prizes could add up to the listed prize amount in the smallest number of plays. For example, a Pick 4 ticket winning \$2,000 could have won in two plays (one 4-Way Box win of \$1,200 and one 6-Way Box win of \$800) or in three plays (one 4-Way Box win of \$1,200 and two 12-Way Box wins of \$400 each), and we used the two play combination for our analysis.
- Next, we selected the component prize (from any of the possible combinations found in the previous step) that was equal to or greater than \$500, had the highest probability of winning, and the lowest price. In the previous example, we would treat the \$2,000 winning Pick 4 ticket as a single \$800 win.
- In certain circumstances, the component prize with the highest probability of winning was not the one with the lowest cost. This was the case for some Pick 4 tickets with possible component prizes of both \$800 (which has a 1-in-1,667 probability of winning and a price of \$1) and \$600 (which has a 1-in-2,500 probability of winning and a price of 50¢). We ran tests to determine which of these prizes would result in the most conservative result from our analysis, and found that the \$600 prize results in a lower minimum spend amounts. Therefore, \$600 was used as the component prize in these situations.



### **Multiple Tickets Redeemed on the Same Day**

If an individual redeemed multiple tickets for the same draw game on a single day, we assumed that these tickets were all played in a single draw and, therefore, were not independent wins. When we encountered this circumstance, we selected only one of the winning tickets for our analysis. If these winning tickets had different probabilities of winning and/or prices, we kept the ticket with both the highest probability and the lowest price. If there was no ticket with both the highest probability of winning and the lowest price, we kept the ticket that produced the lowest minimum spend amount. This assumes that claimants are not saving winning tickets from multiple draws and claiming them all at once.

### **Multiple Betting Scenarios for Winning a Set Prize Amount**

For some lottery games, there may be multiple ways of winning a particular prize amount. For example, a Pick 4 player can potentially win the top prize of \$5,000 by buying a \$1 ticket and playing a Straight bet, or by buying a \$24 ticket and playing a 24-Way Combo Play. These different plays have different prices because their probabilities of winning increase as the price increases.

We ran multiple possible scenarios in which a player can win \$5,000 with a single Pick 4 ticket. The results showed that \$1 Pick 4 tickets produce the lowest estimated minimum spend amount to win \$5,000 prizes from individual Pick 4 tickets. In situations where a single prize has multiple possibilities, we assumed that the ticket was a play of the lowest price possible because this produced the most conservative estimate.

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## Outlier Claims

One claimant — the Charleston-B claimant discussed in Chapter 3 — received payment for a winning ticket for a game that was not identified. It was, therefore, excluded from our analysis.

Additionally, the program we used could not produce a result for another individual — the Longs claimant discussed in Chapter 3 — in our list. This claimant redeemed tickets on only three different dates, and as a result, had only three distinct tickets that could be analyzed. If the program cannot produce a result with a probability of 1-in-10 million or lower that any South Carolina resident would win as frequently as the claimant, it will return a result of “no optimal solution found.” In order to win as frequently as the Longs claimant (i.e. to win with three \$1 tickets), one would need to spend a minimum of \$3. If every resident of South Carolina spent \$3 on the lottery, there would be about a 5-in-1 million chance that any person would win as frequently as the Longs claimant. This 5-in-1 million probability is greater than the 1-in-10 million maximum probability used in our analysis, and for this reason, the program returned an error message.

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## Instant Ticket Probabilities

To determine the appropriate probabilities of winning for instant tickets, we matched the claimed prize amounts to the prize and probability information retrieved from SCEL’s website. The probabilities of winning for instant games were taken from the probabilities at the start of the game. If there were multiple ways to win a given prize on an instant ticket, the probabilities were added together.

# Agency Comments

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May 31, 2019

Mr. K. Earle Powell, Director  
Legislative Audit Council  
1331 Elmwood Avenue, Suite 315  
Columbia, SC 29202

Dear Mr. Powell:

Thank you for the opportunity to respond to the final report prepared by your staff entitled *A Review of the South Carolina Education Lottery and Its Oversight of Retailers and Players*. Although we take issue with several broad aspects of the report, the conversations generated during the review process helped the South Carolina Education Lottery (SCEL) to re-examine and improve our practices.

The operation of a state lottery is highly unique and different from the operation of other state agencies. SCEL appreciates the efforts the Legislative Audit Council (LAC) staff made to understand lottery operations and our enforcement measures. To further this effort, in the last five months alone SCEL provided the LAC over 1,500 pages of explanatory information and follow-up questions to correct errors and misinterpretations prior to the completion of the final report. Although the LAC addressed many of our concerns, we believe this report still reflects a misapprehension of the SCEL mission and responsibilities found in the Lottery Act. Additionally, it is important to understand that while the LAC cites policies and practices in other jurisdictions, those references are not an attestation as to the effectiveness or success of those policies and practices. SCEL is confident, given the variations in laws of each jurisdiction, that our compliance activities and measures are as effective as or more effective than any lottery in North America.

While it is not possible to provide a detailed response to a report of almost one hundred pages in the space allowed, SCEL seeks to clarify and respond to several topics referenced throughout the report. In doing so, it should not be assumed that SCEL necessarily agrees or disagrees with a particular LAC recommendation for which a response is not specifically provided.

## **I. Use of LAC's Suggested Probability Analysis.**

### **1. LAC's Suggested Probability Analysis Does Not Aid in Enforcement.**

SCEL takes the issue of frequent claimants very seriously. Prior to and independent of this audit, SCEL was aware of and either had reviewed or was in the process of reviewing each of the claims submitted by the frequent claimants cited by the LAC. **The LAC compiled a list of frequent claimants using essentially the same means and methods as SCEL prior to applying the professor's probability analysis and only applied that analysis to a little less than half of the claimants identified in the report. The probability analysis suggested by the LAC did not reveal a single frequent claimant unknown to SCEL.**<sup>1</sup> Most importantly, no action, administrative

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<sup>1</sup> In consultation with a statistician, SCEL researched and was unable to find any peer review evaluating the professor's method or any scrutiny of the findings of the professor's probability analysis model. It is unknown to SCEL if this model has been validated by experts in the same field as the professor.

or otherwise, may be taken against a retailer or player based solely upon the suggested “probability analysis.” The LAC fully acknowledges that “the improbability of frequent claiming patterns is not necessarily an indication of wrongdoing by retailers or players but could be used as a basis for and component of further and more effective investigation and for administrative actions.”

There are two main issues with the suggested uses of the LAC’s probability analysis model. Firstly, the probability analysis can only be used *after* identifying frequent prize claimants. There is no monitoring and/or detection component of the analysis; each new claim has to be identified by SCEL and then entered in the software. There is no investigatory component of the analysis insofar as it does not provide any new information regarding the claims or the claimant. Each claim and claimant would still be subject to SCEL’s rigorous review and investigation to obtain evidence of misconduct as is SCEL’s current practice. Secondly, the probability analysis employed by the LAC could only be used as singular evidence if a standard of improbability could be set. Yet, the LAC never provided a standard for improbability. SCEL routinely sees players overcome seemingly insurmountable odds to win prizes. Without a clear standard for a Minimum Spend Amount (MSA) or an improbability from a claim pattern, the suggested probability analysis has limited, if any, value in an investigation.

To the contrary, SCEL must and does seek sustainable facts obtained through interviews and other investigatory methods conducted by SCEL’s Security personnel and, potentially, law enforcement personnel, if criminal conduct is suspected. Respectfully, SCEL does not believe the LAC’s probability analysis enhances our ability to prove misconduct. Since the point of the LAC’s work is to critique performance and offer suggestions for improvements, this part of the report amounts to a non-material finding that detracts from, rather than assists, established enforcement means and methods employed by SCEL.

## **2. Untested Massachusetts Model Is Inappropriate for South Carolina.**

The one state identified by the LAC that was cited as using a probability analysis as a basis to deny payment of claims for winning tickets had not yet applied the method to any claimants when SCEL contacted representatives to more fully understand their policy in early 2019. That model would result in a greatly reduced sample size of claimants under scrutiny in South Carolina. Only 6 of the 43 claimants identified in this report would have been investigated. Suggesting that SCEL consider devoting resources to implement a totally untested, unproven enforcement scheme seems to counter the notion of applying best practices and improved oversight to SCEL. (See also section II.5).

## **3. Number of Individual Claimants with Current, Independent Claims is Overstated.**

Over the nine-year period (Nov. 2008 – Nov. 2017) the number of frequent claimants in the Summary (page 1) drops by 40% from 10 to 6 when only independent tickets are considered (meaning that winning wagers for the same draw are ignored because it does not affect the probability of winning). Thus, collectively, 6 individuals,<sup>2</sup> out of almost 74,000 individuals who filed claims with SCEL, presented 468 tickets from the total of 141,452 tickets paid by the SCEL Claims Center during these nine years. Within the full list of claimants in table 3.3 of the report, the number of claimants would drop by 50% from 18 to 9. The LAC did not use the suggested probability analysis to assess the claims by claimants in tables 3.7, 3.8, or 3.9, so the claims provided

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<sup>2</sup> SCEL appreciates the extensive and coordinated efforts of LAC and SCEL staffs regarding the review of claimants with 50 or more tickets. Unfortunately, the same coordination did not occur with those claimants of less than 50 tickets. In table 3.4, on the first line, this claimant is the same as Greer-A in table 3.7; of the \$477,423, there were two claims of \$200,000 each (2 separate instant tickets in 2 separate years). On line two of table 3.4, \$300,000 was won from one ticket and the remaining 31 tickets netted \$53,704. On the third line, one ticket had a prize of \$100,000 and the remaining 24 tickets yielded \$44,410.

in those tables include identical bets. For the claimants in table 3.4, the LAC applied the analysis but did not identify the impact of identical bets. For some claimants, those unidentified identical bets equal more than half of the total prize amount.

The number of frequent claimants would drop by 50% from 10 to 5 in the Summary if considering only frequent claimants who have made a recent claim. When a player has not made a recent claim, an investigation of that person's claim(s) would be an imprudent expenditure of resources because there is no activity from which to obtain evidence of misconduct. SCEL explained this reasoning to the LAC, yet the LAC chose not to disclose whether the claim activity cited in their report is presently actionable. Of the 43 total frequent claimants identified in the full report, only 20 have made a claim within the past year, 23 have not submitted a claim in over a year, 17 have not submitted a claim in over 2 years, and 5 have not submitted a claim in over 5 years.

Of the five retailer claimants identified in the Summary and in Table 3.3 of the report, only one currently has an active retailer license and two of the other claimants' licenses were revoked in 2012 for unrelated reasons. In 2014, SCEL enhanced the scrutiny of frequent claimants and as of this writing, SCEL has reviewed claim activity of an average of 132 claimants each quarter; an average of 10 claimants each quarter had a provable affiliation with a retailer, including licensees, operational managers, claimants who shared a mailing address with a retailer, and other affiliations, including claimants whose affiliations were established through unrelated investigations.

#### **4. Unable to Replicate LAC's Probability Results.**

In spite of our concerns over the benefits or usefulness of the suggested probability analysis, SCEL attempted to replicate the LAC's results and arrive at a better understanding of the "conservative assumptions" (in addition to those beginning on page 87). After several failed attempts at replication and numerous written questions to and responses by the LAC, we were denied multiple requests for an opportunity to sit together so the LAC could demonstrate the use of the suggested probability analysis. In effect, the LAC recommends SCEL use a probability model without demonstrating how the tool was used.

## **II. Resale/Discounting of Tickets by Retailers and Players.**

### **1. Background.**

The LAC refers to the act of reselling (as repetitively explained to the LAC, the term "discounting" is the common term used in the lottery industry) throughout the report. Because no law provides that discounting by a retailer is prohibited, SCEL amended the retailer contract in 2011 to expressly forbid discounting by retailers, which was the only step that SCEL could take. It may be helpful to provide a more in-depth explanation of the nature of these referenced transactions.

"Discounting" is a voluntary transaction regarding a bearer instrument (winning ticket) that is defined by law to be negotiable. "Discounting" **IS NOT** when an owner or clerk steals winnings from a player by scanning a player's winning ticket at the sales terminal and then paying the player an amount less than the winning amount. This conduct is a criminal offense (theft and/or fraud), that is investigated, and the retailer's license will be revoked. Discounting committed by retailers or non-retailers is a voluntary, consensual act: a person agrees to buy a prize from a ticket (one already scratched or one for which the draw has been conducted, i.e., "a played ticket") for less than the full value of the prize. The retailer contract prohibits retailers from engaging in discounting and allows for expedited license suspension/revocation with a lower standard of proof irrespective of whether the transaction was legal or criminal.

## **2. Legal Disagreement with the LAC.**

As acknowledged by the LAC, there is no express statutory prohibition against what the LAC describes as “the resale of winning lottery tickets” (see Summary page 3). Rather than debating SCEL’s position, the report could, more appropriately, have merely recommended that the General Assembly create such an express statutory prohibition, like the other jurisdictions that have express provisions prohibiting the practice of discounting. With all due respect, the LAC’s suggestion for an advisory opinion by the Attorney General is not a workable answer and would be a futile exercise. It has been the Attorney General’s long standing policy, and as recent as March of this year, to defer to an administrative agency’s reasonable interpretation of the statutes and regulations that it administers, consistent with the ruling in the 2014 S.C. Supreme Court case Kiawah Development Partners, II v. S.C. Department of Health and Environmental Control (see Op. S.C. Atty. Gen., 2019 WL 1644873). An opinion adopting the LAC viewpoint guarantees litigation against SCEL by a claimant after a claim is denied. Having SCEL spend money on litigation that would otherwise go to the General Assembly to be appropriated for education seems to be a poor use of resources.

Additionally, while SCEL appreciates the LAC’s attempt to restate our legal interpretation, the difficulty with the LAC’s position is readily evident in the Summary. The LAC concludes that the law is clear and quotes the 2014 S.C. Supreme Court opinion: “a court must first determine whether the language of a statute...directly speaks to the issue....” (Emphasis added). One paragraph later the LAC states that an opinion of the Attorney General is needed: “because the practice is not *explicitly* prohibited by state law....” (Italics original). In compelling SCEL to deny a claim without an express statutory prohibition, a court would not be “utiliz[ing] the clear meaning of a statute...” and is contrary to Kiawah as cited by the LAC.

## **3. Speculation is not a Substitute for Evidence of Widespread Discounting.**

The LAC suggests that discounting is widespread and must be made illegal to protect players and/or ensure more debts owed to the state are collected (no federal debts are subject to collection). This assumption is contrary to our experience and there is absolutely zero evidence presented by the LAC that discounting is widespread, or even common. For the LAC’s speculation to be valid there would have to be people (buyers) who are soliciting purchases of prizes from the universe or “market” of people who owe child support or other debts or vice versa. The various safeguards in place for players were explained to the LAC. Retailers are informed through the retailer contract that discounting will result in a suspension or revocation of the retailer license. The LAC had nine years of claims information and full access to SCEL Security files to substantiate its assertions but instead presented what amounts to inferences as to why someone would engage in discounting a ticket.

The LAC had access to review all debt set-off records to determine if avoiding debt repayments may encourage discounting. The LAC, to our knowledge, did not attempt to determine if the trend lines for debt set-off withholding has changed over time. It might be reasonable to infer that over time as our practices are known, there would be some decline in debt set-off withholdings. SCEL presented evidence to the LAC that the debt set-off trend line was reasonably stable over the past several years.

## **4. SCEL’s Contract Provision on Anti-Discounting by Retailers is the Most Appropriate.**

While SCEL will implement any requirement that may be adopted by the General Assembly, SCEL believes that the players’ interests are protected by contractually prohibiting a retailer or one of its employees from engaging in discounting. Contractual compliance measures taken by SCEL to discourage discounting by retailers are a much more effective, business-like approach than adopting an outdated regulatory scheme as suggested by the LAC that can take a long time to change.

SCEL does not believe the General Assembly needs to review and approve a more expensive and more bureaucratic option when the LAC provides no tangible, specific evidence that more



regulations are needed. Enforcement through fixed regulations following the Massachusetts model would, by its terms, allow a retailer more than one infraction when here, one offense will likely result in a suspension. SCEL has the flexibility under the Contract provision to have the punishment fit the conduct in a less formal, less expensive, but effective manner. A regulation with the same flexibility as the contract provision is unnecessary.

#### **5. Prohibiting Discounting by Non-Retailers.**

If the General Assembly makes discounting by non-retailers illegal, SCEL will implement it to the best of our ability. Again, there is no tangible evidence presented or evidence that SCEL is aware of that discounting is common, let alone widespread. From a practical standpoint, preventing discounting among players will be exceedingly difficult and effective, uniform, and fair enforcement would be virtually impossible. However, SCEL does review high-frequency claimants who are not retailers to determine if there is a connection with a retailer. The majority of frequent claimants reviewed are not affiliated with a retailer. A ticket holder with a valid winning ticket has a binding contract with SCEL and SCEL must have provable evidence to invalidate that contract and refuse payment. Lawsuits are currently pending in at least one other jurisdiction where claims were denied to players who were not retailers. It does not appear to be sound business practice to take money from education to defend such lawsuits and potentially pay damages and attorney fees of a plaintiff. When there is suspicion of misconduct, SCEL already conducts a thorough investigation and denies a claim when the facts warrant.

### **III. Oversight of Retailer Activities and Approach to Ensure Compliance.**

The general theme of the report in this area seems to be that more rigid regulations are needed with structured penalties rather than focusing on SCEL's approach to compliance and evaluating the effectiveness of our means and methods. There is also a suggestion that a change in the regulatory structure is needed based upon conjecture rather than evidence of a problem. This portion of our response explains some information SCEL provided to the LAC that did not appear in the report.

#### **1. SCEL's Approach to Compliance is an Innovative Model.**

As a relatively small entity, SCEL takes a team approach in compliance and every aspect of the duties charged to us by the General Assembly to best serve our statutory mission. This teamwork begins with a stringent licensing process and background checks. Although not required by statute or regulation as a prerequisite for licensure, SCEL requires business licenses, owners' drivers' licenses, the retail lease contracts, inventory bills of sale, and/or other documents that are reviewed, as necessary, by our Legal and/or Security departments for further consideration. SCEL uses its internal database to determine if any prior relationships exist with SCEL that would disqualify a retailer. The Executive Director seeks input from field staff and has required in-person meetings with some applicants to assist in making licensure decisions. SCEL well exceeds what the law requires. This thorough retailer screening by multiple departments on the front end pays compliance dividends in the long-run.

To review ongoing activities, there is a vetting/triage process for every call or email that comes to SCEL. This process was explained to the LAC with accompanying documentation. We strive to respond to every concern on the day it is presented which range from disliking a game's play style to more serious matters. Calls not immediately resolved are forwarded to multiple departments (Security, field staff, and the Executive Director, among others) for proper communication and to ensure a timely follow-up. All matters addressed by Security are vetted and then documented as the facts warrant, including investigation by law enforcement. Researching reports of transactions that are recorded in our central gaming system can resolve many complaints but not all. The LAC reviewed Security logs and had access to the files, including parts of redacted law enforcement files.

Unfortunately, the report focuses on instances that the LAC considered SCEL as lenient followed by the perceived need for a “sanction schedule” promulgated by regulation. Respectfully, while these reviews may not be designed to find positive performance, we sincerely believe the LAC missed an opportunity to explain a new and innovative “collaborative compliance model” that other lotteries might find beneficial. Instead, the report points SCEL toward an antiquated rigid regulatory model designed for a bureaucracy; not the direction we believe the General Assembly intended.

## **2. No New Regulations are Needed or Required.**

With the foregoing in mind, it is essential to understand that SCEL has complied with all statutory requirements regarding the promulgation of regulations. Within days of the sale of the first lottery ticket, as required by law, SCEL submitted regulations to the General Assembly that covered all aspects of our interaction with retailers and claimants. There is no need or requirement in the law that requires the promulgation of a penalty schedule.

Specifically, SCEL does not believe that the Administrative Procedures Act (APA) or § 59-150-60(A)(3) requires the promulgation of regulations. The LAC reading of the APA is incorrect because what the LAC seeks to have SCEL add to the regulations is not an “agency statement of general public applicability” or a “general licensing criteria and condition” but involves activities subsequent to licensure that are currently addressed by a statute, regulation, or contract. South Carolina Code Ann. § 59-150-180(A) requires the retailer contract “must specify the reasons for which the contract may be canceled, suspended, revoked, or terminated by the commission....” Every area raised by the LAC is covered by the Lottery Act and the retailer contract, which calls for a specific penalty (i.e., suspension or revocation). SCEL would add the following comments:

- a. **Accepting Noncash for Payments** – The General Assembly may wish to criminalize this conduct but SCEL lacks that authority.
- b. **Selling Tickets to Minors** – S.C. Code Ann. § 59-150-250 makes this a criminal offense. There is no evidence to suggest that underage sales are a problem as stores commonly use the same monitoring procedures as those for tobacco sales.
- c. **Inventory Violations** – Covered by S.C. Code Ann. § 59-150-180(A)(2). All retailers were made fully aware of the inventory compliance program and its expectations. The first warning letter explains future penalties. We believe this is much more transparent than a regulation and allows future issues to be addressed immediately. We also explained to the LAC that putting penalties in a regulation without knowing its effectiveness could be very disruptive to lottery operations. The report’s compliance numbers speak for themselves.
- d. **Illegal Gaming Machines** – These devices are made illegal by S.C. Code Ann. §§ 12-21-2710, 16-19-40, and 16-19-50, and the Lottery Act prohibits SCEL from offering these types of games or devices. As explained to the LAC, the penalty being imposed by SCEL is lower than what is provided in the contract because the purpose for the penalty has been achieved: the violations have dropped to virtually zero in SCEL’s licensed locations.
- e. **Unpaid Retailer Debts** – Retailer compliance with sums owed to SCEL are addressed in S.C. Code Ann. § 59-150-190 and S.C. Code Ann. Regs. 44-90.20. Rather than benchmark SCEL with the debt experience of comparable lotteries; explain how some retailers are revoked prior to the fourth non-sufficient funds; address how aggressively we pursue debt upon revocation; or cite the fact we allow no retailer to sell SCEL products if they have an outstanding debt to SCEL of any amount, the LAC chose to focus on one clause in a regulation as being problematic, which it is not.

We believe the General Assembly, by vesting SCEL with “comprehensive and extensive powers as generally exercised by commissions engaged in entrepreneurial pursuits” (§ 59-150-60(A), not

quoted by the LAC) intended SCEL to operate in a manner different from other state entities. Otherwise, it would not have granted SCEL extensive authority and specific details to include SCEL entering into contracts with retailers. The reliance upon promulgating more regulations or fixed penalties by the LAC staff is misplaced and could, in practice, actually frustrate compliance efforts. Promulgation of additional regulations would make the compliance process much more bureaucratic, and SCEL would be much slower in adjusting penalties for misconduct or incentives for compliance. Regulations are too often used against an agency to frustrate or delay enforcement. SCEL uses its regulatory authority by striving to create a culture of compliance.

All of the foregoing is simply meant to explain that the general APA provisions cited by the LAC must and can be read in a harmonious manner with the Lottery Act. The contractual references in the Lottery Act are not in conflict with the APA. The General Assembly is presumed to know its prior enactments when it passes new legislation and the words in the Lottery Act must have meaning. The LAC's reading of the APA would render SCEL's mandate to enforce compliance by contract largely, if not completely, meaningless. SCEL complied with the APA and the Lottery Act with the promulgation of our regulations in 2002. No new regulations are needed because what the LAC seeks to have us do, has no general application under the APA.

### **3. Transferring Oversight to Another Entity is Not Warranted or Efficient.**

Integrity is earned every day, but years of accumulated goodwill can all be lost in an instant. The operational integrity at the core of SCEL's corporate culture is largely unseen by our players. However, a retailer's misconduct can put an indelible stain on SCEL's reputation in the eyes of that store's customers. Every time a retailer or its employee does something wrong, it stands to affect SCEL more than the retailer because collectively, the retailers are perceived as the face of SCEL. Well-run and compliant retailers increase lottery sales. Poorly-run businesses or those that engage in misconduct go out of business. Consequently, assisting in inventory control, monitoring for anomalies, among other items, are helpful to SCEL as well as the retailer. While the LAC prefers rigid punishment schedules, we find that our approach works better. Another agency may choose to impose fines for retailer violations; despite retailer requests, SCEL does not allow retailer violations to be forgiven by simply paying a fine. Paying a fine would amount to buying the right to sell lottery products and is not an effective enforcement or deterrence tool.

The regulatory/business relationship we have with the retailer network is beneficial, and we believe the General Assembly purposely established SCEL to act and regulate with a business mindset. To be dependent upon another entity for enforcement and compliance could place the revenue available for transfer to education in jeopardy because ethical behavior of our retailer network is a key to our success. If another agency failed to meet our high standards for compliance, sales and transfers for education would likely be affected because the public may lose confidence in lottery operations.

We provided the LAC with information regarding the penalties imposed over the past several years. It may have been helpful if the LAC had benchmarked SCEL against other lotteries with a similar structure. Instead, the LAC referenced the Ontario Lottery and Gaming Commission (OLG) as an example of transferring oversight to another entity, but the OLG still executes day-to-day oversight of retailers. SCEL was unable to obtain any compliance or enforcement statistics from OLG.

Because personnel from Licensing, Finance, Security, Information Technology, Legal, and the Field work together, we learn about our retailers to a degree that we believe is among the highest in the country. Finance, Security, Licensing, and Field personnel are very proactive in analyzing suspicious patterns, and we have assisted retailers by uncovering employee theft before the retailer is aware of the problem. While the LAC minimizes the effectiveness of deactivating a terminal, such action allows us to quickly investigate a concern and is a critical tool to enhance the retailer's cooperation

and compliance. Most importantly, once we believe the facts support a suspension or revocation, we remove our products, signage, and sales terminal from that location. SCEL does not allow a retailer to sell our products pending the resolution of the appeal.

In sum, there is no incentive for SCEL to continue to do business with a retailer who does not follow the rules as this small subset of retailers consumes an inordinate amount of time and resources. With almost 3,900 licensed retailers, we found that eliminating those who cannot follow the rules enhances SCEL's overall productivity.

#### **4. Retailer Compliance Checks are Ongoing and Confidential.**

SCEL chooses to protect the confidentiality of its investigations by not generally publicizing the results of its retailer compliance checks, as is common practice with law enforcement undercover operations that focus on potential criminal conduct. Law enforcement investigations are different than administrative restaurant inspections and nursing home ratings. The LAC overgeneralizes when it states that local law enforcement advertises that checks are occurring and publishes their results. While local law enforcement advertises the occurrence and publishes the results of traffic related operations (e.g. seatbelt checks, sobriety checks, among others), local law enforcement does *not* publish the results of *most* undercover operations.

SCEL is moving forward with its retailer compliance checks, which provide sufficient evidence for criminal and/or administrative discipline where misconduct is present. Regardless of what SCEL staff may "know," neither criminal nor administrative discipline is appropriate **without evidence** of misconduct. For a time, lack of evidence stymied SCEL's investigation of the Lamar claimant from page 39 of the report; however, SCEL diligently continued its efforts, obtained evidence of misconduct, and revoked the Lamar claimant's license.

SCEL continues to believe that the confidentiality of the program is necessary for authentic interactions between the investigators and the retailers. Recently, the Simpsonville claimant from page 39 had his lottery license revoked because a clerk stole winnings from a player and the clerk was subsequently arrested. The final disposition of the criminal charges and the administrative penalties is forthcoming. Had the clerk known or suspected that the player was assisting in a retailer compliance investigation, the outcome would be different, which is why confidentiality of the process is essential.

The LAC recommends that a "suggestive approach" should be used throughout compliance checks for discounting. The example presented seems to be a textbook example of the criminal defense of entrapment, which occurs when the idea for a crime and the ability to commit are given to a person by an officer of law. SCEL prefers to rely on trained law enforcement to determine the best manner to conduct this type of compliance checks.

### **IV. Other Areas Mentioned by the LAC.**

#### **1. Suggested Debt Set-off Could Have Unintended Consequences.**

If the General Assembly lowers the threshold for debt set-off withholdings from \$5,000 to \$501, SCEL will fully implement that change; however, as the time required to process claims will increase it may be more costly and it will increase the burden on another agency. While the Department of Employment and Workforce and the Department of Social Services provide databases that are loaded into our electronic claims process, the debt set-off check performed in conjunction with the Department of Revenue (DOR) involves a separate phone call to DOR for each claim so their staff can research their databases. If the claim is presented in person, the person must wait during this processing or we can mail a check.

We did not have adequate time (within the allotted five days for this response) to confirm the numbers presented on page 25 of the report as this recommendation was not in the preliminary draft, however, we have collected an average of \$198,000 on behalf of other agencies per year over the past four fiscal years.

## **2. Collecting Data on Retailers' Employees and Family Members and Banning Play.**

To the extent that the LAC would have SCEL review claims to identify those submitted by operational managers and owners currently in our database, it is manageable to conduct this review, but current law allows these individuals to play the lottery. If the LAC seeks to prohibit retailer play, prohibit employee play where they work, and deny claims for family members, effective and efficient enforcement of this scheme is not feasible, but SCEL cannot decide who is eligible to play.

Only the General Assembly can decide who may play SCEL games and when they may be played. SCEL fully complies with current law in collecting personal information of all owners and operational managers. However, SCEL does not intend, without a clear statutory direction, to collect sensitive data that includes personal identifying information (dates of birth, addresses, and social security numbers) for purposes of matching a claim with a player whom the LAC would deem ineligible. Banning play of retailer's employees while at the store where they work might be accomplishable by amending the retailer contract, but effective enforcement would only be possible with a database of the collected intrusive data described herein, and then more extensive investigatory efforts by Security staff, and additional risk associated with the custody of such data.

Even if the sensitive data was available, the information would require consistent updating as employee turnover in convenience stores is extremely high and clerks sometimes work at more than one retailer outlet. Conducting adequate research on ineligibility prior to paying a claim would be expensive and time consuming which calls into question whether compiling the database is a good return on the investment.

If the General Assembly wishes to consider any statutory changes in this area, SCEL asks to be able to supply input to minimize implementation issues that have occurred in other jurisdictions.

## **3. Anonymity.**

Contrary to the assertion by the LAC, SCEL relies upon the specific provision, S.C. Code Ann. § 30-4-40(a)(2) that allows information of a personal nature where the public disclosure thereof would constitute unreasonable invasion of personal privacy to be withheld. This subject is currently under litigation so no further comment will be provided, with the exception that the SCEL Board is comfortable with its position but will act as the General Assembly directs. In response to the LAC's comments, SCEL only releases names and photographs of lottery winners with express permission of the winner. Requests for anonymity are honored.

## **4. Political Contributions by SCEL Commissioners.**

The report indicates that three Commissioners made political contributions to candidates for the General Assembly. This statement is disingenuous. Only one Commissioner made a contribution directly to a candidate and he resigned. The other two members had monies deducted from their salaries by their employers for contributions to political action committees (PAC), never contributing directly to a candidate nor having any decision making role in the respective PAC. Both of these members have been reimbursed by the committees.

SCEL's Orientation materials have a specific section on this topic to assist new Commissioners and it is also covered in our on-boarding process. In the future, SCEL will routinely review filings with the S.C. Ethics Commission for compliance.

## 5. Implementation of Prior Recommendations.

As discussed throughout, SCEL has a clear disagreement with the LAC over when a regulation is necessary and what should be included. While we did not seek to revisit past recommendations, a summary of these may be found in the LAC audit of SCEL in 2014, beginning on page 13.

- a. October 2014 – Rec. 1. – In 2009, SCEL adopted a written policy requiring the game inventory to be pulled from sales after the last top prize has been claimed, which is posted on the SCEL Instant Game Webpage. Because SCEL can control a retailer’s inventory, there is no conflict with S.C. Regulation 44-40.10.C.(2) that allows sales for ninety (90) days after the official end of the game and no amendment to this regulation is needed. Compliance with the end of game process has also been enhanced through the inventory collection program.
- b. December 2005:
  - i. Rec. 12 – See IV.5.a above.
  - ii. Rec. 18 – Addressed 2011 retailer contract amendment. Violations are now virtually zero. The administrative process is the only mechanism by which SCEL can learn of a violation.
  - iii. Rec. 19 – See III.3 paragraph 1 above.
- c. December 2003 – Rec. 6. – SCEL believed that this recommendation had long since been closed. The performance measures discussed on page 81 do not relate to “departmental performance measures.”

In closing, although pages 5-8 of the report discuss Revenue and Expenses, SCEL would like to mention a few items relating to the efficiency of our operations not mentioned by the LAC. Over the past 5 years SCEL has grown revenues by 40%, whereas general operating and administrative expenses have increased only 7%. Based on SCEL’s calculations, which are based on the audited financials of similar lotteries, SCEL’s administrative expenses (operating expenses less advertising expenses) to revenues ratio is the best of all lotteries in the U.S. with revenues of under \$4 billion. SCEL also compares very favorably on its advertising expenditures: the fifth lowest in relation to gross revenue. SCEL spends approximately half of what is allowed under the advertising spending cap (1% of the previous year’s gross revenue). A significant portion of that spending is beneficiary and play responsibly messaging. In FY 2017-2018, Operating Expenses, and Other Game-Related Costs (as shown at Table 1.5) equaled only 2.5% of gross revenues of the 8% allowed by law. **Most importantly, our annual net proceeds for education have grown from \$300.6 million to \$434.8 million from FY13 to FY18.**

Thank you again; we appreciate the opportunity to comment.

Sincerely,



W. Hogan Brown  
Executive Director  
South Carolina Education lottery

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